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No.

IN THE  
SUPREME COURT OF THE UNITED STATES  
October Term, 1982

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In re:

W.T. GRANT COMPANY,

Bankrupt.

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DAVID COSOFF and HELEN FINKELSTEIN,

Petitioners,

- against -

CHARLES G. RODMAN, as Trustee of W.T. GRANT  
COMPANY, Bankrupt,

Respondent.

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PETITION FOR A WRIT OF CERTIORARI  
TO THE UNITED STATES COURT OF  
APPEALS FOR THE SECOND CIRCUIT

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Questions Presented for Review

1. Was a substantial conflict of interests created in violation of principles of law set forth by this Court in Pepper v. Litton, 308 U.S. 295, 300 (1939), and of standards of ethical conduct applicable to attorneys practicing before the federal courts where: (a) an attorney and his law firm sought and received appointment by a bankruptcy court to be attorneys for the bankrupt estate of a corporation; (b) at the time of the appointment, the attorney and his firm were representing and had represented in the past several banks who were leaders of a group of bank creditors who had filed claims as secured creditors with loans of \$657.4 million representing approximately 94% of the assets of the bankrupt estate; (c) at the time of the appointment, the attorney and the leading bank creditors knew that a major portion of the attorney's efforts as counsel for the bankrupt estate would involve conducting litigation on behalf of the estate's general creditors and against the bank creditors involving claims by the general creditors that the bank claimants came before the court with unclean hands for which their liens should be declared void and their claims subordinated to those of the untainted general creditors; (d) after the appointment, the attorney and

his firm proceeded to conduct the anticipated massive litigation against the banks on behalf of the general creditors over a period of two years for which the attorney and his firm were paid by the estate several million dollars in legal fees; (e) while the attorney and his firm were purporting to litigate against the bank creditors over claims to hundreds of millions of dollars in cash held by the estate, he and the firm were simultaneously representing some of the lead banks in connection with other and unrelated bankruptcy matters for which the attorneys were paid substantial fees; and (f) when the bank creditors proposed a settlement of the claims at issue between them and the general creditors, the attorney for the estate and the bankruptcy trustee (who, like the estate's attorney, had admittedly received his appointment through connections with the banks and the banks' attorneys) decided to drop their opposition to the banks' claims, abandon all of the positions of fact and law previously asserted by them in the litigation, accept all of the arguments presented by the banks, and enthusiastically recommend to the bankruptcy court that it accept and approve whatever offer the banks had chosen to make as the best result that could be obtained for the general creditors?

2. If those circumstances did create a significant conflict of interests on the part

of the attorney and his firm in violation of legal principles enunciated by this Court, was that conflict sufficiently substantial to require the bankruptcy court (1) to hold the estate's attorney and his firm unqualified (for reasons of potential bias) to evaluate the proposed settlement or to recommend it to the bankruptcy court under applicable provisions of the Bankruptcy Act and (2) to appoint new and independent counsel to investigate the matter and make recommendations to the bankruptcy court regarding the strength of the general creditors' claims against the banks and the fairness of the settlement proposal by the banks?

3. Where a bank's relationship with a corporation is such that it is both (a) a major creditor with approximately \$100 million in loans outstanding and (b) a paid fiduciary (indenture trustee) for debentureholders of the corporation with approximately \$100 million in bonds outstanding, has the bank committed a clear violation of its fiduciary duties as indenture trustee for the debentureholders for which its interests must be held subordinate to the bankruptcy claims of the debentureholders under the teachings of Pepper v. Litton, 308 U.S. 295 (1939); Dabney v. Chase National Bank, 196 F.2d 668 (2d Cir. 1952), supplemented, 201 F.2d 635 (2d Cir.),

cert. dismissed per stip., 346 U.S. 863 (1953); and related cases\* where: (1) the bank, prior to its resignation as indenture trustee in favor of a successor, participated with two other leading bank creditors (as leaders of a bank creditor group) in the negotiation of guaranties and liens from the corporation which would provide the basis for a contention by the banks (which they would not otherwise have had) that their loans were "senior" to the debt obligations held by the debentureholders and (2) the bank participated with two other "lead" banks in exerting influence over the corporation's management and thereby prevented management from completing a transaction by means of which the corporation would have sold certain accounts receivable and used the proceeds to buy the outstanding \$100 million in debentures from the holders in the open market market for approximately \$30 million?

4. Where (a) two members of a group of bank creditors holding \$657 million in claims against a bankrupt corporation had influential representatives on the bankrupt's board of directors before bankruptcy and two other members of the bank creditor group were indenture

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\* E.g., U.S. Trust Co. v. First Nat. City Bank, 57 A.D. 2d 285, 296 (1st Dept. 1977), aff'd w/o opinion, 45 N.Y. 2d 869 (1978); Morris v. Cantor, 390 F. Supp. 817 (S.D.N.Y. 1975).

trustees for separate groups of debentureholders with claims adverse to the banks' claims of "senior" status and secured interests, (b) protracted litigation arose in the bankruptcy court which pitted the interests of the banks against those of the general creditors (including the debentureholders) in which the bankruptcy trustee and his attorneys undertook to represent the interests of the general creditors, and (c) the bank claimants proposed a settlement with the general creditors which the bankruptcy trustee asked the bankruptcy court to approve, was the bankruptcy court, in evaluating the strength of the bondholders' equitable subordination claims against the banks, required, as a matter of law, to regard the bank claimants as being covered by the "inherent fairness" doctrine of Pepper v. Litton, supra, and other cases, \* under which a bankruptcy court imposes upon an "inside creditor" whose transactions with the bankrupt before bankruptcy are challenged by other creditors seeking equitable subordination the burden of proving by "clear and convincing evidence" that every transaction engaged in to the detriment of the other creditors was "inherently fair" to them?

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\* Geddes v. Annaconda Copper Mining Co., 254 U.S. 590, 599 (1921); In re Midtown Produce Terminal, Inc., 599 F.2d 389 (10th Cir. 1979); Matter of Multiponics, 622 F.2d 709, 717, 720, n. 11 (5th Cir. 1980); In re American Lumber Co., 5 B.R. 470 (D. Minn. 1980).

LIST OF ALL PARTIES TO THIS PROCEEDING

Parties listed in the caption. Jay Miller and Eileen McGinnis, additional appellants below. Robert B. Yates, Jacob and Effie Norvell, Patricia L. Weideman, Charles Hooten, Marvella Associates, Ellis and Irene Beem, Dru-cilla H. Cooper, Joseph and Brigida Granito, Ruth Lowell, Daniel R. Taylor, John A. Taylor, Alexander and Barry Borden, Elizabeth Lane, Joseph Friedman, Richard and Virginia Adams, R. Anthony Adams, Lela and John Coonfield, intervenors-appellants below. James Stephan, Paul C. Van Kirk, Jr. (as Trustee), Bernice L. Yeracaris, Milton A. Levenfeld, IWL Partnership, Hardware Trusts Partnership, BHS Partnership and IWL-FW Partnership, intervenors-appellants below. United States Trust Company of New York, as Indenture Trustee, intervenor-appellee below. John Masse, et al., intervenors-appellees below.

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PETITION FOR A WRIT OF CERTIORARI  
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Petitioners respectfully pray that a writ of certiorari issue to the United States Court of Appeals for the Second Circuit for the reasons set forth below.

DECISIONS OF THE COURTS BELOW

See appendix. The opinion of the circuit court is reported at 699 F.2d 599. The opinion of the district court is reported at 20 B.R. 186. Related decisions by the bankruptcy court are reported at 4 B.R. 53 and 4 Bankr. Ct. Dec. 597.

TIME PERIODS INVOLVED

The decision of the Second Circuit of which review is sought was filed on January 26, 1983. Petitions for rehearing and for in banc reconsideration were filed by petitioners and denied by the circuit court in an order dated and filed on March 8, 1983 (see appendix). This petition was filed within 90 days after entry of the order below denying petitioners' motion for rehearing.

JURISDICTION OF THIS COURT TO HEAR THIS PETITION

This Court's jurisdiction is invoked under 28 U.S.C. §1254(1).

STATUTES, RULES AND OTHER MATTERS INVOLVED IN THIS PETITION

None.

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Set forth above.

STATEMENT OF THE CASE

Petitioners pray that a writ of certiorari issue to review the judgment and opinion of the United States Court of Appeals for the Second Circuit entered in this case on January 26, 1983. Petitioners' motion for rehearing was denied by order dated March 8, 1983. In its opinion below, the circuit court affirmed a decision by the district court (S.D.N.Y., K. T. Duffy, J.) entered on March 16, 1982, in which the district court affirmed a decision

by the bankruptcy court (Galgay, J.) entered on June 23, 1981, which approved, pursuant to Section 27 of the Bankruptcy Act (11 U.S.C. §50), a so-called Amended Offer of Settlement which a group of 26 bank creditors (the "bank claimants") of the bankrupt W.T. Grant Company ("Grant") proposed to make to certain Grant bondholders.

#### The Grant Bankruptcy Proceedings

The Grant bankruptcy proceedings began with the filing of an arrangement petition under Chapter XI of the Bankruptcy Act on 10-2-75. Those proceedings resulted in the largest bankruptcy liquidation proceeding in the history of the federal courts. Grant was adjudicated a bankrupt on 4-13-76. After that, the Grant bankruptcy trustee, Charles G. Rodman, collected over \$700 million in the estate from the sale of Grant's assets.

#### The Amended Offer

The Amended Offer is a proposed settlement offer by a group of 26 bank claimants to the holders of certain Grant debentures for the purpose of resolving certain claims made (in the context of an adversary proceeding before the bankruptcy court) by the bondholders in which the bondholders sought "equitable subordination" against the banks and challenged the validity of (a) \$657 million in claims filed by the bank claimants and (b) liens held by

the banks covering the loans reflected in the banks' claims. The bondholders contended that the equity doctrine of equitable subordination should be applied (1) to the banks' liens and (2) to the banks' argument that their \$657 million in claims should have priority status over the bondholders' \$93.34 million in claims because the bank claims represent "Senior Indebtedness" as that term is used in the trust indenture covering the Grant 4.75% Subordinated Debentures. (See Second Circuit opinion, App. B, n. 6.)

#### Relief Sought

The relief sought by the bondholders was that the banks' claims be equitably subordinated by order of the bankruptcy court to a position either equal to or subordinate to the bondholders' claims. If the bank claims are held to be "senior" to those of the bondholders, the bondholders will take nothing from the estate. If the bank claims are given a status equal to the bondholders, the bondholders will be paid nearly 60 cents on the dollar for their claims. If the bank claims are subordinated to a position below that of the bondholders, the bondholders will be paid in full.

#### The Bondholders' Legal Theory Regarding Their Claim for Equitable Subordination

The legal theory of the bondholders' equitable subordination claim has several parts.

First, the bondholders maintain that the bank claimants owed fiduciary duties to the bondholders for a number of different reasons:

(1) The bank claimants were "inside creditors" who exercised effective control over the financial decisions of the Grant board of directors. Their status as "inside creditors" arose from the fact that the 26 bank claimants acted through three "lead banks" (Morgan Guaranty Trust Company of New York ["Morgan"], Chase Manhattan Bank, N.A. ["Chase"], and Citibank, N.A. ["Citibank"]), with Morgan acting as "agent" for all 26 banks, and Morgan had a representative on Grant's Board of Directors, its Executive Committee and its Audit Committee in the person of Dewitt Peterkin, Vice Chairman of the Morgan bank, who acted as a dominant or controlling force on the Grant board. In addition to Peterkin, the banks were also represented on the Grant board by an officer of Wilmington Trust, one of the bank claimants.

(2) By virtue of having an "inside" position of confidence and great influence or control over financial decisions of the Grant board affecting their interests, the bank claimants had the same fiduciary duties that all of Grant's officers and directors had to its stockholders and creditors once it became known (in June of 1974) that Grant was insolvent and probably headed for bankruptcy.

(3) Chase was indenture trustee for the Grant 4.75% Subordinated Debentures from their issuance until 8-14-74, when it resigned its trusteeship in favor of United States Trust Company as its successor.

(4) Citibank has been indenture trustee for the \$800,000 issue of Grant 4% bonds from their issuance to the present date.

(5) Since the bank claimants acted in concert through Morgan as their "agent" and Morgan, Chase and Citibank as the "lead banks," any tortious acts done against the bondholders' interests in violation of fiduciary duties owed by Morgan, Chase or Citibank were committed by all of the banks acting in coordination or conspiracy.

(6) Under controlling principles of law or equity applicable in bankruptcy proceedings where the doctrine of equitable subordination is sought to be invoked, a heavy burden is placed upon a fiduciary who has engaged in transactions with the bankrupt before the bankruptcy proceedings that provided him with an advantage over other creditors to prove, by "clear and convincing evidence," that every such transaction was "inherently fair" to the other creditors who were not in a position to take advantage of inside information, influence or control over management. Pepper v. Litton, supra, Geddes v. Anaconda, supra, Taylor v. Stan-

dard Gas & El. Co., 306 U.S. 307 (1939); In re Midtown Produce Terminal, Inc., 599 F.2d 389 (10th Cir. 1979); Matter of Multiponics, Inc., 622 F.2d 709, 716-722 (5th Cir. 1980); In re American Lumber Co., 5 B.R. 470 (D. Minn. 1980).

(7) The bank claimants did engage in transactions with Grant prior to its bankruptcy filing that benefited the banks at the expense of the bondholders and prevented the bondholders from being offered \$300 per bond for their debentures in July or August of 1974. In July of 1974, three representatives of the banks (Snyder, an officer of Morgan; Archibald, an officer of Chase; and Roberts, an officer of Citibank) met at the offices of Morgan with Pierson, President of Grant, and told Pierson that they would not allow Grant to proceed with a transaction which the Grant board had previously approved whereby Grant would reduce its crushing annual burden of debt service to the bondholders (and thereby improve cash flow) by selling certain accounts receivable for \$73 million and using part of the cash proceeds to buy the 4.75% and 4% bonds on the open market for around \$300 per \$1,000 bond. This transaction would clearly have been advantageous to the bondholders (who have not received interest payments since 10-2-75 and who are only offered \$190 per bond in the Amended Offer) and, according to an admission made by Peterkin of Morgan to Pierson

of Grant at the time (Pierson dep. at 300-306, 389-391) the transaction would have been advantageous to Grant as well. But Peterkin used his inside position and the banks' control over Grant at the Grant board meeting on 7-23-74 to veto the proposed transaction because, however detrimental the veto might be to the interests of Grant or the bondholders, the banks wanted the accounts receivable to remain assets of Grant until the banks had completed a proposed loan agreement with Grant which would subject the accounts receivable to bank liens and thus make it impossible for Grant to sell them thereafter without permission from the banks.

(8) The proposed loan transaction mentioned by Peterkin at the Grant board meeting on 7-23-74 as one of the reasons for the banks' veto of the sale of accounts and purchase of debentures was intended to improve the legal position of the banks at the expense of other general creditors (and the bondholders in particular) by making Grant, for the first time, a guarantor of over \$415 million in loans made by the banks to "Grant Financial" (a separate but related corporation) and thereby elevating those loans (plus additional loans made for much smaller amounts to keep Grant afloat and away from bankruptcy for at least four months) to "senior debt" status under the trust indenture covering the bonds. A second advantage

sought by the banks was that of making all of their loans (\$415 million in previous loans to Grant Financial plus new loans) subject to liens covering virtually all of Grant's assets, including its accounts receivable. To obtain the benefits of the Grant guarantee and the liens covering loans of over \$400 million which Morgan, Chase and Citibank had unwisely made earlier to Grant Financial on an unsecured basis, those three "lead" banks put up relatively little "new money" in additional loans. Most of the new money lent to Grant would be provided by 116 other banks brought into the shaky Grant situation by Morgan without telling them how bad the situation actually was.

(9) The 1974 loan agreement (with the Grant guarantee and the liens built in) was negotiated by the lead banks while Chase was still indenture trustee for the 4.75% bonds, Citibank was indenture trustee for the 4% bonds, and Morgan and Wilmington Trust were still represented by influential members of the Grant board. A draft of the loan agreement was presented to the Grant board on 7-23-74, indicating that the basic terms had been agreed-upon before that time and that closing the transaction was simply a matter of the banks preparing the necessary documents for execution. That was 22 days before Chase resigned as indenture trustee in favor of U.S. Trust.

(10) The 1979 loan agreement was executed in two stages: an Interim Security Agree-

ment executed on 8-21-74 and an Initial Security Agreement executed on 10-8-74 but dated "as of" 9-16-74. Under the Interim Agreement of 8-21-74, Grant gave guarantees and liens to the banks covering \$44 million in new loans. Under the Initial Agreement of 10-8-74, Grant extended those guarantees to cover a total of \$600 million in loans, of which most was prior debt and not "new money" and all of which was secured by liens covering specified assets of Grant. Chase, Morgan and Citibank arranged for the Grant guarantees and liens to cover \$90 million in loans each, of which \$10 million each represented "new loans" and \$80 million represented previous loans made to Grant Financial on an unsecured and unguaranteed basis.

(11) The acts of the lead banks whereby they (a) deprived the bondholders of an opportunity to sell their bonds to Grant at 30 cents on the dollar and (b) did so in order that they might obtain guarantees and liens on the Grant accounts receivable covering \$450 million in unsecured loans made only to Grant Financial (which is not involved in this or any other bankruptcy proceeding) clearly constituted equitable torts upon the Grant bondholders because, by those acts, the banks sought and obtained advantages over the bondholders in the event that the seriously contemplated bankruptcy proceedings should become reality. This con-

duct was particularly tortious and unconscionable on the part of Chase because it was indenture trustee for the 4.75% bondholders until 8-14-74, a date well after the 1974 loan agreements had been arranged, except for the last details. Under well-established principles of the law of New York (which controls the relationship between Chase and the bondholders under the trust indenture), an indenture trustee has a specific duty to defer the protection of its own economic interests in favor of the interests of its bondholder beneficiaries. Dabney v. Chase Nat. Bank, supra, 196 F.2d 668, 672 (2d Cir. 1952) (opinion by Learned Hand, C.J.); U.S. Trust Co. v. First National City Bank, supra, 57 A.D. 2d 285, 296 (1st Dept. 1977), aff'd w/o opinion, 45 N.Y. 2d 869 (1978); Morris v. Cantor, 390 F. Supp. 817 (S.D.N.Y., 1975, Ward, J.).\*

The Bondholders' Legal Theory Regarding the Conflict of Interests of Harvey Miller and the Firm of Weil, Gotshal & Manges as Attorneys for the Grant Estate in Connection With the Litigation Over the Status of the Banks' Claims

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\* In Morris v. Cantor, as in the present case, the questioned loan transaction was negotiated by Chase with a corporation while Chase was indenture trustee for certain bondholders of the company but the loan transaction was not executed until after Chase had resigned its trusteeship. On those facts, Judge Ward held that the bondholders' complaint stated a cause of action for willful misconduct under the Trust Indenture Act of 1939. 380 F. Supp. at 824.

Petitioners, David Cosoff and Helen Finkelstein, are the co-owners of \$150,000 in face amount of the Grant 4.75% Subordinated Debentures, of which \$92.507 million in principal amount are outstanding. Chase was the indenture trustee for those bondholders until 8-14-74, as explained above.

On 10-2-75, Grant filed its Chapter XI petition. At that time, the banks held \$657.4 million in loans, all of which were made to Grant Financial (not Grant), guaranteed by Grant and covered by liens on Grant's assets. But the liens and guarantees (except for \$44 million lent on 8-21-74) were all obtained on 10-8-74, less than one year before Grant's bankruptcy filing. Therefore, to the extent that the liens and guarantees were given to cover preexisting debt of around \$450 million and not "new loans" made in August of 1974, those liens and guarantees were subject to being voided by the bankruptcy court as having been provided without adequate consideration.

Beyond that, those liens and guarantees provided by Grant were subject to attack on behalf of the bondholders and other general creditors on the ground of "equitable subordination" on the theory, explained above, that, in obtaining them, the lead banks violated fiduciary duties of fairness owed by them to the bondholders and made unconscionable use of their positions as "inside creditors" and "controlling

creditors" to gain advantages over the bondholders in the event of clearly-anticipated bankruptcy proceedings.

On 7-2-76, the banks (through Morgan, as "agent") began an action in the Grant bankruptcy proceeding in the nature of an adversary proceeding seeking a declaratory judgment. The purpose of that proceeding was to enforce the liens acquired by the banks on 10-8-74. The relief sought was a declaratory judgment by the bankruptcy court giving full effect to the liens and, in effect, requiring the bankruptcy trustee to turn over to the banks all of Grant's assets covered by the liens up to the amount of the banks' claims, i.e., \$657.4 million. Since the amount eventually collected by Rodman from liquidating Grant's assets was a little over \$700 million, enforcement of the liens would have taken well over 90% of the assets and left only \$43 million for unsecured creditors with an additional \$450 million in claims.

In response to the banks' adversary proceeding, the cause of the general creditors was taken up by the bankruptcy estate represented by attorney Harvey Miller and Weil, Gotshal & Manges ("WG&M"), the law firm of which he is a member. U.S. Trust Co., as successor indenture trustee for the 4.75% bondholders filed pleadings in opposition to the banks' adversary proceedings but made no ac-

tive effort at all to litigate on behalf of the bondholders against the banks. On or about 9-24-76, Miller filed an answer containing eight defenses and counterclaims on behalf of the estate and for the benefit of the general creditors.

From about October of 1976 to around December of 1977, WG&M spent a great amount of time and effort litigating on behalf of the general creditors against the banks. They expended many thousands of attorney hours in (a) obtaining production of hundreds of thousands of pages of documents from the banks' files and (b) conducting extensive depositions ("Rule 205 examinations") of about 25 witnesses, which resulted in somewhere between 10,000 and 12,000 pages of deposition transcripts. U.S. Trust did not subpoena a single document or question a single witness. Its litigation efforts were limited to sending a junior associate to attend the Rule 205 examinations conducted by WG&M. WG&M has been paid several million dollars as interim fees by the Grant estate for its work in conducting the litigation against the banks and a total of over \$14 million to date for all of its work on the Grant case.

At some point in late 1977 or early 1978, unknown to petitioners' counsel, the discovery process ended and negotiations began of a settlement of the litigation between the banks (as

purported lien creditors and holders of "senior indebtedness" vis-a-vis the bondholders) and the estate (representing the unsecured, general creditors). The participants in those negotiations were WG&M (on behalf of Rodman), Morgan (represented by Davis, Polk & Wardwell, on behalf of the banks) and United States Trust (represented by Whitman & Ransom).\*

On 4-7-78, WG&M filed on behalf of Rodman an application with the bankruptcy court for approval of a so-called "Global Settlement Agreement" by means of which the banks proposed to resolve their disputes with all of the remaining Grant creditors. That goal was not achieved, and the banks have, since 1979, referred to the resulting agreement as the "Bank Settlement Agreement." Judge Galgay approved the Global Settlement Agreement in a 46-page opinion and order dated 7-20-78 (4 Bankr. Ct. Dec. 597).

The Global Settlement Agreement was not "global" because certain parties purporting to represent the interests of the Grant 4.75% and

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\* The banks settled with the Secured Suppliers in an agreement approved by the bankruptcy court on 2-3-77 and (in amended form) by the Second Circuit on 4-6-78. In late 1977, the banks made a settlement offer to the holders of Senior Debentures for whom Morgan was indenture trustee but for whom Fidelity Union bank had assumed Morgan's fiduciary duties. Rodman recommended that settlement for Bankruptcy Judge Galgay's approval, which was provided in an order dated 1-18-78. That settlement became effective as of 4-19-78.

4% bondholders would not accept the terms offered by the banks to them (at that time, less than 8 cents on the dollar). Those claiming to represent the 4.75% bondholders and refusing to accept the banks' terms were Whitman & Ransom (on behalf of U.S. Trust as indenture trustee) and attorney I.W. Bader (on behalf of Morris Lewy, Victor Kurtz and several other bondholders who called themselves the Ad Hoc Bondholders' Committee). As a consequence of that lack of consent, the banks and the estate worked out an arrangement that was incorporated into the Global Settlement Agreement and the order of 7-20-78 approving it whereby a "reserve fund" would be created in the amount of \$95.378 million representing principal and interest on the 4.75% and 4% bonds (\$93.341 million) plus interest to 10-2-75, the date of the Chapter XI filing.\*

The banks created the idea of a reserve fund with the bankruptcy trustee as "stakeholder" of the funds in dispute between them and the bondholder interests and were enthusiastic about it in 1978 because execution and court approval of the Global Settlement Agreement made possible a prompt payout by the estate to

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\* This fund was held unsegregated by the Grant estate as part of its assets and invested in such a way that interest was accumulated on it at the rate of about 10.5% per year which was, in effect, "compounded" every six months by the purchase of new certificates of deposit.

the banks of several hundred million dollars\* which the banks were then extremely interested in getting as soon as possible. At that time, the banks probably thought that a settlement with the bondholder representatives would be possible within a few weeks or months and no later than the end of 1978. No such prompt settlement was reached.

In motion papers filed in April 1978 in support of Rodman's application for approval of the Global Settlement, WG&M advised Bankruptcy Judge Galgay that a case could be proven with evidence then available for applying the remedy of equitable subordination against the banks for the purpose of invalidating the liens obtained on 8-21-74 and 10-8-74. At the time, Judge Galgay apparently accepted that assessment of the factual case and applicable law at face value.

Later, in April of 1979, when WG&M sought to justify their recommendation that the bankruptcy court approve the proposed Original Offer of settlement by the banks to the bondholders of 14 cents on the dollar (with 1% or \$950,000 allowed to Whitman & Ransom as legal fees), it became tactically necessary for them to abandon their earlier opinion that the case for equitable subordination is very strong and take the

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\* The exact amount is unknown to petitioners' counsel but is estimated to have been between \$250 million and \$300 million.

opposite view, i.e., that equitable subordination would be extremely difficult to establish because the available evidence is very weak and the applicable case law requires that a claimant seeking the remedy of equitable subordination has a "very substantial" burden of proof and contractual subordination provisions are enforced under "well-established" case law in the Second Circuit even in cases where the unsubordinated creditors had committed outright fraud upon the contractually subordinated creditors.

This was a complete distortion by counsel for the estate of the available facts and a totally incorrect description of applicable principles of law in the area of equitable subordination. But WG&M apparently regarded this total reversal of its earlier opinion of the case to be necessary in order to support its argument that the Original Offer of 14% to the bondholders was extremely favorable in the circumstances and the best that could possibly be obtained from the banks without additional protracted litigation beyond the 8,000-plus hours already devoted by WG&M attorneys to the litigation.\*

On behalf of U.S. Trust as indenture

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\* As far as the record discloses, Judge Galgay perceived no significant inconsistency between the positive assessment of the case for equitable subordination presented to him by WG&M in April of 1978 and the negative assessment submitted to him by the same firm one year later.

trustee, Whitman & Ransom recommended that Judge Galgay approve the Original Offer of 14% to the bondholders with \$950,000 allowed for the payment of U.S. Trust's attorneys' fees to Whitman & Ransom. Whitman & Ransom also agreed completely with the negative assessment of the equitable subordination claim provided by WG&M on behalf of Rodman, conveniently ignoring the earlier positive assessment by Rodman's attorneys.

The bondholders represented by attorney I.W. Bader (now joined by attorney Bradley R. Brewer as co-counsel) opposed the Original Offer as inadequate because it did not reflect the true strength of the equitable subordination claim on the facts and the law. They agreed with Rodman's original assessment.

Between the bankruptcy court opinion of 7-20-78 approving the Global Settlement and 4-18-79, there were prolonged settlement negotiations leading toward the Original Offer of 14% but no efforts by the estate or U.S. Trust to litigate the bondholders' claims against the banks. On 4-18-79, WG&M filed on behalf of Rodman an application for bankruptcy court approval of the Original Offer by the banks. By this time, the only creditors remaining in the Grant estate with claims at odds with those of the banks were the bondholders.

One of Bader's bondholder clients, Victor Kurtz, retained attorney Morton Robson to

represent him. At the insistence of Judge Galgay, Robson was allowed to appear as co-counsel with Bader for Kurtz. Bader and Brewer remained as co-counsel for Bader's other clients. Brewer was retained by bondholders Cosoff and Finkelstein to represent them as sole counsel.

Attorneys Robson, Bader and Brewer joined forces to oppose the application for approval of the Original Offer. Hearings were held before Judge Galgay on five days between 5-22-79 and 6-19-79.\* On 2-20-80, Judge Galgay filed an opinion and order approving the Original Offer. The objectants took an appeal that was assigned to District Judge William Conner and briefed by May of 1980.

By October of 1980, it became evident that Judge Conner might take another year to decide the appeal, and 18 months had already passed since the Original Offer had been presented to Judge Galgay on 4-18-79. The reserve fund of \$95 million had accumulated over \$15 million in interest, an amount equal to the entire amount of the Original Offer. Bondholders supporting the objectants' opposition to the Original Offer had grown from around 2% at the time of the hearings in May of 1979 to over 30%, and the number was increasing.

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\* The objectants were allowed only 14 days to conduct discovery. During that time, neither Peterkin of Morgan nor any of the significant witnesses from Chase were available to testify.

The banks then decided to withdraw the Original Offer and replace it with an Amended Offer of 19% with 2% (or \$1.9 million) allowed for the payment of attorneys' fees to Whitman & Ransom, Robson, Bader and Brewer.

Robson decided to accept the Amended Offer and persuaded Kurtz to do so. Most of Bader's clients decided to accept the offer, and Bader elected to represent them, despite his personal conviction that the offer was inadequate. Brewer agreed to represent any bondholder who might wish to oppose Rodman's application for approval of the Amended Offer. Petitioners Cosoff and Finkelstein retained him for that purpose on 6-13-81. Judge Galgay held a supplemental hearing on 6-16-81 on the application for approval of the Amended Offer and approved that offer in an order dated 6-23-81. Petitioners appealed to the district court and lost in a decision by Judge K.T. Duffy dated 3-15-82, 20 B.R. 186. Petitioners appealed to the Second Circuit and lost in the decision which they now ask this Court to review and reverse.

Petitioners maintain that there is a reason why attorney Miller and his firm abandoned their earlier positive assessment of the case for equitable subordination and agreed promptly to the Original Settlement Offer by the banks of 14% as soon as it was made and joined forces with the banks and U.S. Trust

in recommending that Judge Galgay approve it as fair and a reasonable reflection of the bondholders' chances of succeeding on the equitable subordination claim.

Attorney Miller was selected by counsel for the banks to be recommended to Charles Rodman, the bankruptcy trustee, and to the bankruptcy court for appointment as counsel for the Grant estate. Rodman was also selected and recommended for the job of trustee by counsel for the banks. Miller represented the bank creditors as secured creditors before the official creditors' committee was formed. When that committee was formed, Miller was selected as one of its co-counsel (representing the banks' interests) and another attorney (who had previously represented trade creditors) was selected as the other co-counsel. Miller represented the banks' interests on the creditors' committee for a period of six months, until the bankruptcy adjudication on 4-13-76. Soon thereafter, the banks recommended Rodman to be bankruptcy trustee and Miller to be his attorney, and the bankruptcy court entered orders appointing both of them.

When Rodman and Miller were appointed to their posts, brief hearings were held before Judge Galgay. Rodman disclosed the circumstances involved in his selection by counsel for Chase first to serve as standby trustee during the Chapter XI period and then to be bankruptcy

trustee after 4-13-76. Miller made limited, but not complete, disclosure of his prior relationship with the bank claimants, and Judge Galgay was familiar with his service as co-counsel for the official creditors' committee. At that time and thereafter, Miller and WG&M were actively representing certain of the bank creditors in other and unrelated bankruptcy cases for which they received substantial fees. Those circumstances and the obvious conflict of interests created by them were not fully or adequately brought to the attention of the bankruptcy judge.

Specifically, two important things were not brought to Judge Galgay's attention in April of 1976, either by Miller or by counsel for the banks, although they were well aware of them. First, Miller had previously represented the banks in connection with the Grant bankruptcy proceeding itself and was continuing to represent them in other matters. The banks were not general creditors but lien or secured creditors. It has long been the law in bankruptcy proceedings that an attorney who had previously represented secured creditors cannot be appointed counsel for the bankrupt estate because the administration of the estate is conducted primarily, if not exclusively, for the benefit of unsecured creditors, and the interests of secured and unsecured creditors are inherently in conflict. In par-

ticular, an attorney who has previously represented a secured creditor should not become counsel for a bankrupt estate where it is known that the security interest of the former client will be challenged in the bankruptcy proceeding. This Court expressly recognized these long-established principles in one of the most-often cited bankruptcy cases of all time, Pepper v. Litton, supra, decided in 1939. 308 U.S. 295 at 300.

The applicable rule of law and the relevant holding of Pepper v. Litton were not brought to Judge Galgay's attention in April of 1976. Section 44(c) of the Bankruptcy Act provides that:

"An attorney shall not be disqualified to act as an attorney for the receiver or Trustee merely by reason of his representation of a general creditor." (Emphasis supplied.)

Judge Galgay was familiar with that provision. It is quite common for an attorney who has previously represented a major general creditor to become counsel for a bankrupt estate, but uncommon (and improper) for an attorney who has previously represented a secured creditor to be so appointed. Apparently, but most unfortunately, Judge Galgay simply failed to note the distinction and its significance for the purposes of Miller's appointment.

The bankruptcy court's misinterpretation of the law in this connection is under-

standable (but no less erroneous) because of the second important thing that Miller and the banks failed to disclose at the appointment hearing in April of 1976. They did not tell Judge Galgay that there was certain to be massive and prolonged litigation between the interests of the general creditors and those of the banks over the validity of the banks' liens and guarantees from Grant and that one of the main tasks of the estate's attorney would be to litigate against the banks with hundreds or millions of dollars at stake. At that time, they knew that, and knew it perfectly well, but no one else did.

Because of the circumstances described above and many others,\* a clear-cut and most

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\* Between 10-2-75 and 10-9-75, Miller received a telephone call from Charles Hoppin, a partner of Davis, Polk & Wardwell, attorneys for Morgan as leader of (or "agent" for) the bank claimants. (Transcript of hearings before Judge Galgay in 1979, p. 584.) Mr. Hoppin told Mr. Miller that the Grant bank creditors wanted him to represent them in connection with the formation of a creditors' committee or "bank committee" in the Grant proceedings.

On 10-9-75, Miller met with Hoppin and other Davis Polk attorneys and began to advise them about the procedures involved in Chapter XI arrangements and what steps are usually taken by the two groups of creditors normally represented by counsel (i.e., the bank creditors and trade creditors) at the first (and informal) meeting of creditors. Among other things, he discussed what "indemnity" is and how the major creditors normally go about establishing a creditors' committee.

Among other things, Miller inquired about the nature of the banks' claims and asked who the banks other than  
(footnote continued on next page)

appalling conflict of interest situation was created and the appearance of impropriety was inescapably generated, which neither Rodman

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(Footnote continued from previous page:)

Morgan were. In response, Hoppin told Miller that the banks were secured creditors of Grant under an agreement created some time before. This knowledge on the part of Miller as early as 10-9-75 that the banks claimed to have valid and enforceable liens on Grant's assets is extremely important for appellants' conflict-of-interest argument against Miller and his firm, because it means that Miller, a specialist in bankruptcy law who teaches that subject in a major law school and frequently lectures on the subject to practicing attorneys, knew that under the bankruptcy rules, he could not be engaged to represent secured creditors in a bankruptcy proceeding and then later be appointed to act as attorney on behalf of the estate for general creditors.

Since (a) the task of a bankruptcy trustee and his attorney is to gather and distribute the estate for the benefit of general creditors and (b) that task imposes upon both of them the duty to examine carefully all security claims and to challenge in court those of doubtful validity, the rules applicable in bankruptcy proceedings have long prevented an attorney who begins his involvement with a bankruptcy proceeding by representing secured creditors from later acting as counsel for the estate and thereby assuming responsibilities potentially antagonistic to his former clients. If it were not so, an attorney might be engaged by certain creditors to draft documents creating certain security interests and then later be engaged by the estate to attack by litigation the validity of the documents that he himself drafted.

On 10-15-75, Miller, as attorney for a committee of bank creditors, attended a Grant creditors' meeting at the Americana Hotel in Manhattan. (Tr. 614) He told those present that he was representing the bank creditors. (Tr. 616) Before that meeting began, Mr. Miller had lunch with an officer of Citibank named Ingram and several other people representing the banks. Mr. Ingram had been designated by the bank claimants to act as chairman of the creditors' meeting.

The purpose of that luncheon meeting clearly was for  
(footnote continued on next page)

(himself an attorney) nor Miller did anything at all to correct. See, In re Eastern Sugar Antitrust Litigation, 697 F.2d 524 (3d Cir. 1982).

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Miller to advise Ingram and the others present concerning what steps should be taken at the creditors' meeting according to applicable law and common practice. Others present at the meeting were a bank officer from Morgan and several attorneys from the Davis Polk firm representing Morgan. Only representatives of the bank creditors, Mr. Miller's clients, were present at the 10-15-75 luncheon meeting.

At the 10-15-75 luncheon meeting, Mr. Miller discussed with those present: (1) the size of the creditors' committee, (2) which bank creditors would place members on that committee, and (3) the question of Mr. Miller being retained as attorney for the creditors' committee after its formation.

At the 10-15-75 creditors' meeting, there was a discussion of the size and composition of the creditors' committee. It was decided that the committee would have 11 members, with 6 members representing the banks and 5 representing other creditors.

Mr. Ingram encountered difficulty in maintaining control of the proceedings. When that happened, Ingram called on Mr. Miller as his counsel to assist in maintaining order at the meeting. In this way, Mr. Miller was identified by Mr. Ingram to all present as an attorney for the bank creditor group.

Once the creditors' committee was formed and the identities of its members determined, the committee met in closed session (only members present) and retained as co-counsel for the committee Mr. Miller's firm (which had represented the banks at the earlier meeting) and Ballon, Stoll & Itzler (which had represented a large group of trade creditors at the preceding meeting). At the luncheon meeting, Miller had told the bank representatives that he had been contacted earlier by the Ballon firm and told that the Ballon firm would be representing trade creditors at the creditors' meeting.

It is common practice in bankruptcy proceedings to have trade creditors and bank creditors dominate and control the first meeting of creditors and for the

(footnote continued on next page)

Based upon those known circumstances, petitioners believe that Miller and WG&M simply capitulated to the banks when the banks proposed the Original Settlement because they and Rodman were deeply beholden to the banks for getting them their respective appointments. Miller's firm has billed the Grant estate somewhere between \$15 and \$20 million for services in the Grant matter, and Rodman has been paid \$250,000 per year to act as bankruptcy trustee. Neither of them could afford to anger the banks by opposing the Original Offer, and, not surprisingly, neither of them did.

Of course, it may be that Rodman, Miller

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attorneys for those groups to be designated attorneys for the creditors' committee upon its formation. Here the trade creditors and bank claimants had potentially conflicting interests arising from the Inventory Security Agreement of 5-15-75 and related circumstances. Both groups (trade and bank creditors) claimed liens.

No explanation was ever provided by U.S. Trust as to why it did not seek a place on the creditors' committee for the \$92.5 million in claims against the Grant estate held by the bondholders for whom it acted as indenture trustee.

Despite the foregoing circumstances, Mr. Miller claimed, during the hearings before Judge Galgay on the Original Offer, that he never learned or had any idea why his firm and the Ballon firm were appointed co-counsel for the creditors' committee. This testimony was disingenuous because it was clear that the Weil Gotshal & Manges firm had been designated because it was counsel for the banks and the Ballon firm had been designated because it was counsel for the trade creditors. The only general creditors represented on the creditors' committee were trade creditors without liens.

and the other attorneys involved at WG&M actually acted in utmost good faith and sincerity when they tailored an argument in support of their recommendation of the Original Settlement to the bankruptcy court in 1979 that was completely inconsistent with what they told Judge Galgay in writing in 1978. But the appearances to the contrary are obvious and disgraceful. Almost any layman informed of these circumstances would be shocked and scandalized.

Petitioners maintain that Miller was manifestly unqualified to be appointed or to act as attorney for the Grant estate at all and should never have been appointed to that position. When it became evident that the estate would have to conduct massive litigation against the banks involving high stakes, Miller and his firm should have resigned as counsel for the estate. Failing to do that, Miller, his firm and Rodman should at least have appointed a totally independent firm of attorneys to litigate against the banks and dissociated themselves completely from any involvement in that controversy. If that had been done, the appearance of conflicting interests and impropriety would have remained but in a substantially less virulent form. As soon as the banks' adversary proceeding was commenced and the apparent conflict of interests became known, Miller should have brought the entire problem before the bankruptcy court

for an open hearing and ruling on the propriety and legality of his conduct. He and his firm have only themselves to blame for their failure to do so.

In response to this argument and to petitioners' contention that (1) Miller and WG&M were unqualified either to litigate against the banks on behalf of the bondholders or to present an objective evaluation of either the Original Settlement or the Amended Settlement to the bankruptcy court pursuant to §27 of the Bankruptcy Act and (2) the bankruptcy court's approval of the Amended Offer was fatally flawed by that court's failure to appoint an independent attorney to investigate the bondholders' claims and present an untainted opinion and recommendation, the Second Circuit below refused to "find that any of the relationships charged by appellants were disqualifying" and that the facts regarding Miller's earlier representation of the banks in connection with the Grant bankruptcy were limited to only five days of actual, formal representation and were, therefore, in the judgment of the panel, "de minimis." Petitioners most strenuously disagree, and they urge this Court to do so as well by granting the requested writ and subjecting the decision and record below to a most searching review.

Petitioners submit that the circuit court panel below applied the wrong standard of judg-

ment to the obvious conflict of interest problem involved in this case. As the Third Circuit recently pointed out in the Eastern Sugar case, supra, the proper test where a conflict of interest is perceived on the part of an attorney acting by court appointment in a fiduciary capacity on behalf of thousands of persons not represented by their own counsel is not whether the circumstances are shocking to the minds of three case-hardened federal judges with years of experience in observing instances of dishonest behavior but rather whether the circumstances would be shocking to an average layman informed of them.

What the average layman would think about the conflict of interest problem in this case is obvious. He would be shocked and disappointed at the behavior of Mr. Miller and shocked even more by the decision of the Second Circuit on this point. If you don't believe it, find one and ask him.

REASONS WHY THIS PETITION SHOULD BE GRANTED AND ARGUMENT

See discussion above.

CONCLUSION

For the reasons set forth above, this petition for a writ of certiorari should be granted.

Respectfully submitted,  
*Bradley R. Brewer*  
BRADLEY R. BREWER  
Attorney for Petitioners  
799 Broadway, New York, N.Y.  
(212) 777-4010

A P P E N D I X

UNITED STATES COURT OF APPEALS  
SECOND CIRCUIT

At a stated term of the United States Court of Appeals, in and for the Second Circuit, held at the United States Courthouse, in the City of New York, on the eighth day of March, one thousand nine hundred and eighty three.

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IN RE

W.T. GRANT COMPANY,

No. 82-5019

5023

Bankrupt.

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A petition for rehearing containing a suggestion that the action be reheard in banc having been filed herein by counsel for appellants, David Cosoff and Helen Finkelstein.

UPON CONSIDERATION by the panel that heard the appeal, it is

ORDERED that said petition for rehearing is DENIED.

It is further noted that the suggestion for rehearing in banc has been transmitted to the judges of the court in regular active service and to any other judge on the panel

that heard the appeal and that no such judge  
has requested that a vote be taken thereon.

A. Daniel Fusaro, Clerk

by Francis X. Gindhart,  
Chief Deputy Clerk

UNITED STATES COURT OF APPEALS  
FOR THE SECOND CIRCUIT

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No. 381—August Term, 1982

(Argued November 19, 1982 Decided January 26, 1983)

Docket Nos. 82-5019, 82-5023

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IN RE:

W. T. GRANT COMPANY,

*Bankrupt,*

DAVID COSOFF and HELEN FINKELSTEIN,

—and—

JAY MILLER and EILEEN MCGINNIS,

*Appellants,*

—v.—

CHARLES G. RODMAN, as Trustee of  
W.T. GRANT COMPANY, Bankrupt,

*Appellee,*

ROBERT B. YATES, JACOB AND EFFIE NORVELL, PATRICIA  
L. WIEDEMAN, CHARLES HOOTEN, MARVELLA ASSOCI-  
ATES, ELLIS AND IRENE BEEM, DRUCILLA H. COOPER,  
JOSEPH AND BRIGIDA GRANITO, RUTH LOWELL,  
DANIEL R. TAYLOR, JOHN A. TAYLOR, ALEXANDER AND

BARRY BORDEN, ELIZABETH LANE, JOSEPH FRIEDMAN,  
RICHARD AND VIRGINIA ADAMS, R. ANTHONY ADAMS,  
and LELA AND JOHN COONFIELD,

*Intervenors-Appellants,*

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JAMES STEPHAN, PAUL C. VAN KIRK, JR. (as Trustee),  
BERNICE L. YERACARIS, CONSTANTINE A. YERACARIS,  
MILTON A. LEVENFELD, IWL PARTNERSHIP, HARDWARE  
TRUSTS PARTNERSHIP, BHS PARTNERSHIP, and IWL-  
FW PARTNERSHIP,

*Intervenors-Appellants,*

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UNITED STATES TRUST COMPANY OF  
NEW YORK, as Indenture Trustee,

*Intervenor-Appellee,*

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JOHN MASSE, et al.,

*Intervenors-Appellees.*

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Before:

WATERMAN, FRIENDLY and MESKILL,

*Circuit Judges.*

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Appeals by holders of 4 3/4 % subordinated debentures  
of W.T. Grant Co. from an order of the District Court for

the Southern District of New York, Kevin Thomas Duffy, *Judge*, 20 B.R. 186 (1982), approving the proposal by Grant's bankruptcy trustee of a settlement between the debentureholders and the bankrupt estate. Affirmed.

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BRADLEY R. BREWER, New York, NY (Brewer & Soiero, New York, NY), *for Appellants Cosoff and Finkelstein*

STUART A. JACKSON, New York, NY, *for Appellants Miller and McGinnis*

HARVEY D. MILLER, New York, NY (Weil, Gotshal & Manges, New York, NY), *for Appellee Rodman as Trustee*

JAMES C. SARGENT, New York, NY (Whitman & Ransom, New York, NY), *for Intervenor United States Trust Company of New York*

I. WALTON BADER, White Plains, NY (Bader and Bader, White Plains, NY), *for Intervenor Masse, et al.*

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FRIENDLY, *Circuit Judge*:

These appeals arise from the mammoth bankruptcy proceedings of W.T. Grant Co. before Bankruptcy Judge Galgay in the Southern District of New York. Grant initially filed a petition for an arrangement under chapter

XI<sup>1</sup> on October 2, 1975, and was adjudged bankrupt on April 13, 1976. Secured suppliers, holders of senior debentures, bank creditors, general unsecured creditors, and holders of two issues of subordinated debentures filed claims against the bankrupt estate. The present appeals concern the last of a series of compromises and settlements<sup>2</sup> designed to avoid what would necessarily have been extremely protracted litigation with the various claimants. We shall assume familiarity with Judge Galgay's opinions and will endeavor to state only what is necessary to an understanding of these appeals.

### *The History of Grant's Financings*

Prior to July, 1973, Grant, which operated a large chain of retail stores, generally satisfied its short-term cash needs by selling commercial paper through a wholly owned subsidiary, W.T. Grant Financial Corporation (Grant Financial); it had relatively small revocable lines of credit at several hundred banks.<sup>3</sup> In the spring of 1973 Grant determined that a portion of the commercial paper

<sup>1</sup> All references are to the Bankruptcy Act of 1898 and the Rules thereunder.

<sup>2</sup> The earlier ones were a compromise and settlement with the secured suppliers, approved by the Bankruptcy Court on Feb. 3, 1977, *aff'd*, Docket No. 78-5010 (2 Cir., April 6, 1978); a compromise and settlement with senior debentureholders approved Jan. 18, 1978; a compromise and settlement with the bank claimants approved July 20, 1978, 4 Bankr. Ct. Dec. 597; a first order approving a compromise and settlement with the junior debentureholders dated Feb. 20, 1980, 4 B.R. 53; and a further order dated June 23, 1981, approving a revised form of this settlement, from which the appeals here at issue were taken.

<sup>3</sup> For example, as of Jan. 31, 1973, Grant had only \$10,000,000 in bank debt, all of it short term, as against \$380,033,500 in outstanding commercial paper.

outstanding should be converted into long-term debt and approached Morgan Guaranty Trust Co. of New York (Morgan Guaranty) to structure a \$100,000,000 five year term loan. On July 5, 1973, Morgan Guaranty arranged such a loan to Grant Financial from eight banks replacing an equivalent amount in their lines of credit to Grant. Among these banks were, in addition to Morgan Guaranty, Chase Manhattan Bank, N.A. (Chase), which was the trustee under an indenture under which \$92,507,000 of Grant's 4 $\frac{3}{4}$ % unsecured subordinated debentures issued April 15, 1971, were outstanding as of the date of filing under Chapter XI, and First National City Bank, now Citibank, N.A. (Citibank), which was trustee under an indenture under which \$834,000 of Grant's 4% unsecured subordinated debentures issued June 1, 1965, were outstanding as of the date of filing under Chapter XI.

Grant's financial performance declined during 1973 and in December Moody's and Standard and Poor's lowered Grant Financial's commercial paper ratings from prime 1 to prime 2 and also downgraded Grant's long-term securities. Grant resorted to borrowing under its lines of credit. On March 5, 1974, Moody's withdrew Grant Financial's commercial paper rating and further downgraded Grant's long-term securities. Faced with the need to raise more than \$132,000,000 in order to meet commercial paper maturities in the next week, Grant asked the eight banks to reestablish their lines of credit. They did this in proportion to their prior exposure, with the result that their loans and advances to Grant Financial shortly reached \$415,000,000. Even this borrowing was not enough; in August, 1974, Morgan Guaranty, Chase and Citibank each advanced an additional \$5,000,000 to Grant (Secured Demand Loans) secured by an assignment of certain accounts receivable. Later in August, 1974,

Grant Financial, Grant as guarantor, and eleven bank lenders entered into an Interim Loan and Guaranty Agreement wherein Grant Financial became indebted to the eleven banks in the aggregate amount of \$44,000,000 by assuming Grant's obligation to repay the \$15,000,000 of Secured Demand Loans just described and incurring New Loans of \$29,000,000, all such loans being guaranteed by Grant and secured under an Interim Security Agreement dated as of August 21, 1974, by accounts receivable arising out of the sale of goods at designated stores. This brought the total short-term and long-term loans from Grant's 12 major bank lenders to approximately \$517,000,000.

The Interim Loan and Guaranty Agreement was shortly succeeded by a Loan and Guaranty Agreement dated as of September 16, 1974, which became effective October 8, 1974, less than a year before Grant filed under Chapter XI. The parties were Grant Financial, Grant as guarantor, and 143 banks. The maturity of all outstanding short-term unsecured loans and the \$44,000,000 of secured loans under the Interim Agreement was extended through June 2, 1975, and the banks agreed to increase their loans to \$600,000,000. The obligations of Grant Financial were to be guaranteed by Grant. An Initial Security agreement dated September 16, 1974, secured the \$600,000,000 total of outstanding short-term loans and future commitments under the Loan and Guaranty Agreement and the \$100,000,000 long-term notes issued under the Term Loan Agreement of July, 1973.<sup>4</sup> On the

<sup>4</sup> The security was to consist of all of Grant's customer accounts receivable and the securities of Zeller's Ltd., a Canadian subsidiary of Grant. The security was pledged ratably for the benefit of \$23,995,000 of Grant's 4½% senior sinking fund debentures. All financing statements required to perfect security interests under the Initial Security Agreement were timely filed by Morgan Guaranty as agent.

date when the Loan and Guaranty Agreement became effective, the banks advanced an additional \$66,587,500, thereby reaching the \$600,000,000 in loans due June 2, 1975, contemplated by the agreement, plus the \$100,000,000 represented by the July, 1973, Term Loan Agreement. As of April 1, 1975, Grant, Grant Financial and Morgan Guaranty entered into a Loan Extension Agreement actually executed June 2, 1975, within four months of the filing of Grant's Chapter XI petition. This provided for paying off a debt of \$56,931,665.59 to 116 banks whose individual loans to Grant ranged from \$50,000 to \$5,000,000 and the extension to March 31, 1976, of outstanding short-term loans in the principal amount of \$540,916,978 made by the other banks.

Somewhat earlier Grant had been obliged, in order to induce its largest vendors and suppliers to continue providing it with credit, to enter into an Inventory Security Agreement dated as of May 15, 1975, wherein Grant gave a lien on designated store inventories to specified vendors and suppliers. Under the Loan and Guaranty Agreement, the bank claimants were to receive a lien on inventory junior to that of the suppliers and the senior debenture-holders.

The final transaction was an Amended Loan Extension Agreement entered into as of August 6, 1975, which became effective on September 15, 1975. This further extended the maturity of the \$540,916,978 of short-term bank loans to July 30, 1976; subordinated \$300,000,000 of that debt to certain trade obligations (the "Trade Subordination Agreement"); and subordinated Grant Financial's loans of \$819,887,663 to the banks' total claim of \$640,916,978 (the "Intercompany Subordination Agreement").

*The Proceedings in the Bankruptcy Court  
and the District Court*

After Grant had been ordered into liquidation, the banks and Charles G. Rodman, as Trustee, asserted a multitude of claims against each other in an adversary proceeding, the details of which are described in Judge Galgay's opinion, 4 Bankr. Ct. Dec. at 601-02. The Trustee conducted an elaborate investigation into the affairs of Grant under Bankruptcy Rule 205(a). This encompassed production of the books, records and other documents of Grant, and examination of its remaining and former officers, directors and employees. Before any extensive discovery by the banks, settlement negotiations were instituted. These resulted in an agreement which, in addition to settling the claims of the banks, encompassed what Judge Galgay termed a "global settlement", i.e., a "framework for the further administration of the bankrupt estate and the satisfaction of claims filed against such estate." 4 Bankr. Ct. Dec. at 602. So far as here relevant, the settlement provided that the bank claimants were to receive an initial cash distribution of \$165,700,000, or approximately 25% of their allowed claims. More was to be paid when and if funds became available. The Trustee agreed not to sue the 116 banks whose loans of \$56,931,665.59 were paid in June, 1975. Finally, the agreement created a fund of \$95,378,373, the full amount of the claims of subordinated debentureholders, pending resolution of their dispute with the bank claimants as to whether the subordination clauses of their indentures should be given effect so as to subordinate the debentureholders's claims to the bank claims. The Bankruptcy Judge approved the banks' settlement on July 20, 1978, finding that "[t]he Trustee will have achieved a

result for the estate which approximates, and may exceed, the results which are likely to be achieved by the continued prosecution of his defenses in the Adversary Proceeding" which the bank claimants had initiated, 4 Bankr. Ct. Dec. at 609. There was no appeal of this "global settlement" to the district court.<sup>5</sup>

Having thus provided the necessary framework, the Trustee, the bank claimants, United States Trust Company (U.S. Trust) as indenture trustee replacing Chase under the Indenture for the 4¾% Subordinated Debentures, and representatives of these debentureholders entered into negotiations for the settlement of the latter's claims. The rights of the debentureholders depended on the interpretation and application of a clause in their indentures subordinating their claims to "Senior Indebtedness" of Grant. The Indenture under which the 4¾% Debentures were issued defined this as stated in the margin;<sup>6</sup> the Indenture securing the small amount of

<sup>5</sup> An "Ad Hoc Protective Committee of 4¾% Convertible Subordinated Debentures of W.T. Grant Company", including Mr. Victor Kurtz and represented by I. Walton Bader, raised objections to the banks' settlement at the hearing. The failure by Mr. Kurtz's "Protective Committee" to pursue its objections by appealing from the Bankruptcy Judge's allowance of the banks' claims forecloses some of the issues raised in the present appeal. While Judge Galgay expressly reserved "the claims of Subordinated Debentureholders purportedly represented by the Ad Hoc Protective Committee" pending subsequent determination of "the validity and enforceability of the subordination provisions contained in the Subordinated Debentures and related Trust Indentures," 4 Bankr. Ct. Dec. at 608, this reservation of claims against the bankrupt estate and, by extension, against the bank claimants, does not go still further to permit, e.g., re-opening of the question whether the Trustee properly agreed not to question the June, 1975, payments of \$56,931,665.59 to the 116 other bank creditors of Grant.

<sup>6</sup> The term "Senior Indebtedness" shall mean the principal of and premium, if any, and interest on (a) indebtedness (other than the Debentures and the Convertible Subordinated Debentures due June

outstanding 4% Debentures was to the same effect. If the bank claims were and remained enforceable as Senior Indebtedness to which the debentureholders were subordinated, the latter would receive nothing. However, U.S. Trust alleged that for a number of reasons the conduct of the banks might require the contractual subordination provisions be disregarded and even that the subordinated debentureholders be accorded a status prior to that of the banks.<sup>7</sup> These reasons, stated in detail in Judge Galgay's

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1, 1990 of the Company) of the Company for money borrowed from or guaranteed to persons, firms or corporations evidenced by notes or similar obligations, (b) indebtedness of the Company evidenced by notes or debentures (other than the Debentures and the Convertible Subordinated Debentures due June 1, 1990 of the Company) issued under the provisions of an indenture or similar instrument between the Company and a bank or trust company or (c) purchase money indebtedness of the Company, in each case, whether outstanding at the date of execution of this Indenture or thereafter incurred; unless, in each case, by the terms of the instrument by which the Company incurred, assumed or guaranteed such indebtedness, it is expressly provided that such indebtedness is not superior in right of payment to the Debentures. As used in the preceding sentence the term "purchase money indebtedness" shall mean indebtedness evidenced by a note, debenture, bond or other instrument (whether or not secured by any lien or other security interest) issued or assumed as all or a part of the consideration for the acquisition of property, whether by purchase, merger, consolidation, or otherwise; *provided, however*, that such term shall not include any account payable or any other indebtedness created or assumed by the Company in the ordinary course of business in connection with the obtaining of materials or services.

<sup>7</sup> We reject the objectants' assumption that the doctrine of equitable subordination must invariably work to reverse the positions of senior and junior creditors. The equitable powers of the bankruptcy court are broad, *Pepper v. Litton*, 308 U.S. 295, 304-05 (1939), and it may "adjust . . . equities among the creditors" in a flexible manner, Herzog & Zweibel, *The Equitable Subordination of Claims in Bankruptcy*, 15 Vand. L. Rev. 83, 87 (1961). Before considering a complete reversal of priorities, the bankruptcy court would have been obliged to weigh the less drastic remedy of placing a culpable senior creditor on a plane of equality with junior creditors.

opinion approving the settlement, 4 B.R. at 60-61, were as follows:

- (a) At the time of the Initial Security Agreement of September 16, 1974, the bank claimants knew or had reasonable cause to believe that Grant was insolvent and that the granting of security interests would discourage further extensions of trade credit to Grant and substantially reduce the flow of merchandise into Grant stores, thereby impairing the prospects for a successful reorganization of Grant.
- (b) By forcing Grant into the Inventory Security Agreement and Trade Subordination Agreement the bank claimants increased the amount of Senior Indebtedness to which the junior debentureholders were subordinated.
- (c) In the summer of 1974, the bank claimants directed Grant not to proceed with a proposed sale of \$100,000,000 of customer accounts receivable to Beneficial Finance Corporation and the use of some undetermined portion of the proceeds to purchase 4¾% debentures at 25 cents on the dollar.
- (d) The bank claimants used their position of control over Grant's management to prevent Grant from promptly seeking relief under the Bankruptcy Act, feeding it just enough money to keep its head above water while strengthening their security position, allowing the passage of the four months period for avoiding preferences under § 60a and hoping to allow the passage of the one year provision of § 67d(2) for the avoidance of liens and fraudulent transfers.

The bank claimants made a variety of responses. They denied having had any fiduciary relationship to Grant,

asserted that they had made loans in the belief fostered by Grant's management that Grant remained viable, contended that Grant's management itself had abandoned the proposed sale of accounts receivable, and denied that they had prevented Grant from seeking rehabilitation under the Bankruptcy Act. They asserted, moreover, that as to many U.S. Trust's claims, the remedy, even if the claim were made out, would be invalidation of the banks' security interests rather than subordination to the debentureholders. U.S. Trust also raised claims of conflict of interest and derelictions of duty against Chase, its predecessor trustee, to which Chase answered.

The settlement originally provided for the payment of 14% of the claims of the accepting subordinated debentureholders. All rights of non-acceptors were preserved, and neither the offer nor the bank settlement agreement was to have any effect in any proceeding brought by them. The indenture trustees, U.S. Trust and Citibank, were, however, to be released from all further obligations to enforce the rights of debentureholders under their respective indentures.

At a hearing before Judge Galgay objections were made by eleven debentureholders, led by Victor Kurtz as chairman of an "Ad Hoc Protective Committee of Holders of 4¾% Debentures", see note 5, *supra*, and represented by I. Walton Bader. A group of Institutional Investors also raised objections at the outset but have played no subsequent role in the case. The Kurtz objectors asserted principally that the Trustee had failed to make a presentation of the facts and law adequate to support approval of the settlement, that the bank claims should be equitably subordinated to the debentures because of the control and dominion over Grant allegedly exercised by the banks, and that the Trustee, U.S. Trust

and their respective counsel are subject to conflicts of interest which require them to be disqualified. Acknowledging the task imposed by *Protective Committee for Independent Stockholders of TMT Trailer Ferry, Inc. v. Anderson*, 390 U.S. 414, 424-25 (1968)<sup>8</sup>, Judge Galgay, after 27 pages of discussion, 4 B.R. at 57-84, concluded that the original settlement represented a fair compromise, taking into account the strengths and weaknesses of the claims of both sides and the delay and expense incident to litigation,<sup>9</sup> and approved it on February 20, 1980.

Timely appeals were taken to the District Court (Conner, J.) by Kurtz and nine other debentureholders represented by Bader and Morton Robson (No. 80—Civ. 1857), and by debentureholder Levy and three others

<sup>8</sup> Initially we found it somewhat troubling that Judge Galgay applied the language of *Anderson* to the Trustee, 4 B.R. at 69, rather than to himself. While it is surely necessary that a trustee should perform these duties, his having done so does not relieve the bankruptcy judge from repeating the process, giving appropriate weight to the recommendations of the trustee and his counsel. However, Judge Galgay's opinion shows that he thoroughly understood this.

<sup>9</sup> There has been much to-do about how far Judge Galgay's opinion represented his independent analysis as distinguished from a rubber-stamping of the findings of fact and conclusions of law prepared by counsel for the Trustee. Judge Galgay expressed, 4 B.R. at 57, his awareness of the caution in *United States v. El Paso Natural Gas Co.*, 376 U.S. 651, 656-67 (1964), that trial courts should not slavishly follow one party's proposed findings of fact and conclusions of law. He acknowledged having "adopted findings of fact and conclusions of law submitted by the Trustee for the reason that they accurately state and reflect the true state of the record" so that "[i]t would be a waste of judicial time on my part merely to rephrase proposed findings and conclusions so accurately stated." *Id.* At our request the counsel for the Trustee has made available his proposed findings and conclusions, and we have compared them with Judge Galgay's. We find that while Judge Galgay did adopt most of the Trustee's proposed findings of fact, especially as to the terms of the settlement, almost verbatim, he prepared his own legal discussion, and appellants' charge that the opinion was that of counsel rather than of the judge is a gross exaggeration.

represented by Bader and Bradley R. Brewer. The latter did not take an appeal on behalf of his present clients, David Cosoff and Helen Finkelstein, who were not named objectants but had asked Mr. Brewer to represent them at the time of the hearings before the Bankruptcy Judge. Before the appeals could be heard, negotiations looking toward an improvement of the offer were begun. Judge Conner stayed consideration of the appeals and allowed negotiations to go forward under the Bankruptcy Judge's supervision. See *In re W.T. Grant Co.*, 13 B.R. 1001, 1002 (S.D.N.Y. 1981). These resulted in an amended offer. The amount payable to the debentureholders was raised from a floor of 14 cents on the dollar to one of 19 cents on the dollar.<sup>10</sup> Interest on the reserve fund calculated from the date of approval by the bankruptcy judge would run for the benefit of the debentureholders. Solicitation of acceptances could start immediately. As soon as the tendering debentureholders were paid, the banks could also draw down the remainder of the \$95,378,373 reserve fund set aside under the bank settlement agreement.

A conference on certain details was held in Judge Galgay's chambers on April 16, 1981. The appearance list shows Robson as appearing for "Kurtz et al." and Bader for "Bondholders". There was much discussion of the withdrawal of the appeals from Judge Galgay's order of February 20, 1980. Robson and Bader agreed that, subject to certain contingencies later worked out, they would withdraw their appeals with prejudice. Bader announced that although he had brought Brewer into the case and Brewer had signed his name on the briefs, Brewer was not

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<sup>10</sup> Additional amounts not in excess of 2 cents on the dollar might be paid if allowed fees and expenses amount to less than 2% of the face value of all debentures tendered.

the attorney for the Levy appellants, who were Bader's clients, and had not signed the notice of appeal. Robson's and Bader's stipulations withdrawing appeals from the February 20, 1980, order with prejudice and without costs were signed and so ordered.

In the further proceedings before Judge Galgay relating to the new settlement offer, objections had to be submitted in writing by June 12, with a hearing to be held on June 16. Brewer filed no written objections by June 12 because no one had authorized him to do so. A day later appellant Cosoff retained him to oppose the settlement. At the hearing on June 16 Judge Galgay gave him time to argue; Brewer there objected only to an alleged inadequacy of notice and to the provisions concerning attorneys' fees. By order dated June 23, 1981, Judge Galgay approved the amended offer, which has now been accepted by some 80% of the debentureholders. On July 1, 1981, Cosoff and Finkelstein, represented by Brewer, and Miller and McGinnis, originally represented by Douglas F. Eaton and now by Stuart E. Jackson, filed notices of appeal, which on this occasion came before District Judge Duffy. The grounds of appeal were largely those that had been argued before Judge Galgay at the hearing on the first settlement offer.<sup>11</sup> On March 15, 1982, Judge Duffy affirmed the order of the bankruptcy court, 20 B.R. 186 (S.D.N.Y. 1982), primarily on the ground that the dismissal of the appeals from the order of February 20, 1980, rendered that order *res judicata*. The instant appeals are from Judge Duffy's order.<sup>12</sup>

<sup>11</sup> Judge Duffy noted, 20 B.R. at 189 n.4, that appellants had "arguably failed to preserve their claims for appeal by not properly articulating or presenting them in the bankruptcy court", but did not rely on this.

<sup>12</sup> An appeal was also taken by a number of debentureholders, all represented by Mr. Brewer, (No. 82-5021) which, because none of these

*Discussion*

Although the trustee in bankruptcy has not raised the point and U.S. Trust Company has done so only feebly, we begin by noting some concern whether appellants have standing to appeal in light of the fact that the settlement leaves them free to pursue their remedies. We see nothing in the argument of their counsel that they are entitled to represent accepting debentureholders since a rejection of the settlement would necessarily lead to a still further improvement in the offer. There can be no such assurance. Although the banks indeed moved rather quickly from 14 cents to 19 cents, there must be a point at which the banks would prefer to litigate rather than give up more in settlement, and no one knows but the banks and their counsel where that is. Beyond this there is no proof that accepting debentureholders have authorized appellants to appear for them. Appellants' argument with

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debentureholders had earlier appealed from the bankruptcy court to the district court, was dismissed for lack of standing without prejudice to later motions by these debentureholders for leave to intervene. Seventeen of this group, led by Robert B. Yates, have been granted permission to intervene and have amplified appellants' contention that the Bankruptcy Trustee's counsel should have been disqualified, *infra*, pp. 26-28. Another nine, led by James Stephan, have been allowed to intervene and have alleged conflicts of interest on the part of United States Trust Co., successor indenture trustee for the 4¼ debentures, and its counsel. In addition, leave to intervene was granted to a faction of debentureholders, led by John Masse and represented by I. Walton Bader, who support the amended offer of settlement but oppose United States Trust Co.'s application for fees pursuant to that offer. United States Trust Co. has also been permitted to intervene in support of the amended offer and in defense of its own conduct and that of its counsel.

The Stephan intervenors point to alleged conflicts of interest arising out of United States Trust Co.'s desire to obtain fees for its services and its potential liability for breaches of fiduciary duty committed by its predecessor Chase. We see no basis for the charges of misconduct leveled by the intervenors against United States Trust Co. and its counsel.

respect to standing must be rather that in a case of this sort the right of an individual debentureholder or even of a considerable group of such holders to assert their claims against the embattled forces of ten of the country's largest banks, once deprived of the resources afforded in the past by the bankruptcy trustee and the indenture trustee, is more fiction than fact. With claims of 80% of the debentures settled, the threat to the banks by a few holdouts is not substantial. Bringing the bankruptcy trustee, or the indenture trustee, or both, back to the negotiating table or to court is the only realistic recourse to preserve an opportunity for debentureholders who have not yet accepted to achieve more. The situation is comparable to that of court-approved settlements of class actions, in which "even where class members had the right to exclude themselves from the class, they may appeal from an order approving a settlement which they deem unsatisfactory," 3B Moore, Federal Practice ¶ 23.80[5] (2d ed. 1982), lest small claimants "be faced with equally unpalatable alternatives—accept either nothing at all or a possibly unfair settlement," *Ace Heating & Plumbing Co. v. Crane Co.*, 453 F.2d 30, 33 (3 Cir. 1971).

We have little doubt as to the correctness of Judge Duffy's observations about *res judicata* in the usual case or even in most cases of the approval of settlements in bankruptcy. An appeal by one creditor will not save the situation for another if the first withdraws his appeal—if for no other reason than that the time for the other to take an appeal will generally have expired. See 9 Moore, Federal Practice ¶ 204.11[4] (2d ed. 1982). Here the latter obstacle does not exist. The operative order was Judge Galgay's order of June 23, 1981, approving the revised settlement and the Cosoff-Finkelstein and Miller-McGin-

nis appeals were timely. By the time the Kurtz and Levy appeals from the February 20, 1980, order were withdrawn the amended offer had been made public and, if the appeals had not been formally withdrawn, Judge Conner would surely have found some way of getting rid of them rather than devote his time to hearing appeals from an order that was about to be superseded. Apparently the reason why withdrawal of the appeals was sought was to permit speedy dissemination of the new offer without having to await the the district court's decision as to the superseded offer, see 20 B.R. at 188; that purpose was accomplished. We see no indication that anyone thought at the time that the withdrawal of the appeals from the February 20, 1980, order with prejudice would deprive objectors to the new offer of a right to appeal on the merits if Judge Galgay were to approve this. Beyond all this, policy considerations weigh against a rigid application of *res judicata* when such serious attacks have been made upon the bankruptcy trustee and his counsel, the present and former indenture trustees for the 4¼% debentures, and the bankruptcy judge. We therefore proceed to Judge Duffy's alternative ground of decision, on which he did not elaborate, that the appeals are lacking in merit. 20 B.R. at 190. While we could remand the case to him to perform the task of a detailed analysis of the settlement and ordinarily would do so, nearly three years have elapsed since the initial approval of the settlement, and a remand and subsequent appeal would doubtless add nearly another year.

In undertaking an examination of the settlement, we emphasize that this responsibility of the bankruptcy judge, and ours upon review, is not to decide the numerous questions of law and fact raised by appellants but rather to canvass the issues and see whether the settlement

"fall[s] below the lowest point in the range of reasonableness", *Newman v. Stein*, 464 F.2d 689, 693 (2 Cir.), *cert. denied sub nom. Benson v. Newman*, 409 U.S. 1039 (1972). We shall not attempt to deal with every argument advanced by appellants but will concentrate on what seem the most nearly persuasive.

We start with appellants' argument that, quite apart from the banks' conduct, part or all of the banks' claims are not "Senior Indebtedness", see note 6, *supra*, to which alone the claims of debentureholders are subordinated. We can pass over the frivolous argument that the language does not cover further borrowings, to which Judge Galgay gave the treatment it deserved, 4 B.R. at 70-72. Appellants next argue that until Grant's guaranty of August 21, 1974, the banks' claims did not qualify as Senior Indebtedness of Grant since their loans were not to Grant but to Grant Financial. Judge Galgay thought a sufficient answer to be that Grant's indebtedness to Grant Financial was evidenced at the time of the filing of the Chapter XI petition by an Intercorporate Demand Note in the amount of \$819,887,663, more than the amount of the banks' loans to Grant Financial, and that this would qualify as Senior Indebtedness if the corporate entities are respected; if they are not, as well might be proper, the loans to Grant Financial, all evidenced by notes, would qualify even more directly. Beyond this, the \$15,000,000 Secured Demand Loans of August 1974 were originally made directly to Grant, and the \$44,000,000 loaned under the Interim Loan and Guaranty Agreement of August 21, 1974, was guaranteed by Grant. Finally, under the Loan and Guaranty Agreement all loans by Grant Financial were guaranteed by Grant. While this did not become effective until October 8, 1974, which fell 6 days short of a year of the Chapter XI petition, there is no showing

that the trustee could have established lack of fair consideration for the guaranty under § 67(d). The legal standard in a situation such as this, which is governed by § 67(d)(1)(e) of the Bankruptcy Act, is whether "the economic benefit . . . that accrued to [the] bankrupt as a result of the third person's indebtedness" was "'disproportionately small' when compared to the size of the security that that bankrupt gave and the obligations that it incurred," *Rubin v. Manufacturers Hanover Trust Co.*, 661 F.2d 979, 993 (2 Cir. 1981). See also *Klein v. Tabatchnick*, 610 F.2d 1043, 1047 (2 Cir. 1979). Through its subsidiary, Grant received the full benefit of the extended maturity of some \$490,000,000 in short-term loans and additional loans up to the total amount of \$600,000,000 in return for its guaranty and for security interests, see note 4, *supra*, estimated by the Bankruptcy Judge to amount to \$288,000,000, 4 Bankr. Ct. Dec. at 606. We thus conclude that while the subordinated debentureholders have some arguments that the larger part of the bank debt would not qualify as Senior Indebtedness because the loans initially were made to Grant Financial rather than to Grant, these did not have much chance of prevailing.

Appellants contend that, however things might otherwise stand, the banks are estopped from claiming that Grant's indebtedness to Grant Financial constituted Senior Indebtedness because the prospectus under which the 4¾% Debentures were issued showed Senior Indebtedness of only \$28,775,000 whereas Grant then owed Grant Financial \$246,420,216. The Bankruptcy Judge accepted the Trustee's answer that where there is a conflict between a prospectus and the language of an indenture, the latter controls, citing *In re Discon Corp.*, 346 F. Supp. 839, 844 (S.D. Fla. 1971). Appellants' argument,

however, is not really one of construction; they say that even if the words are sufficient, Grant, allegedly with the banks' knowledge, acted in such a way as to make it inequitable for the banks to rely on the words. Yet even if this were upheld—and we find no proof of the banks' complicity in Grant's prospectus, the point remains that the prospectus goes on to define Senior Indebtedness as, *inter alia*, "indebtedness . . . for money borrowed from or *guaranteed to* persons, firms or corporations evidenced by notes or similar obligations" (emphasis supplied). Grant's fresh guaranty of the indebtedness of Grant Financial to the banks in 1975 would itself therefore qualify as Senior Indebtedness even if some principle of estoppel were to prevent the banks from claiming that the unguaranteed intercorporate loans from Grant Financial would not have done so in 1971.

Once it is concluded that there was a strong probability that all of the bank debt would be deemed Senior Indebtedness and a certainty that some of it would be, appellants' other claims lose much of their force. It is true, as appellants urge, that the contractual subordination of the debentures to the bank debt would not prevent the bankruptcy court, as a court of equity, from placing the debentures on a plane of equality with or even, although this is harder to envision, see note 7, *supra*, of superiority to all or part of the Senior Indebtedness if the banks had engaged in inequitable conduct. However, what appellants disregard is that in judging the equity of the banks' conduct their position as creditors *prima facie* senior to the debentureholders must be taken into account. We see no reason to quarrel with the substance of Judge Galgay's summary of the law of equitable subordination, 4 B.R. at 74-75, although every judge would probably state his own version differently. We entirely agree with his conclusion

that "[a] creditor is under no fiduciary obligation to its debtor or to other creditors of the debtor in the collection of its claim", 4 B.R. at 75, and cases there cited. See *Weinberger v. Kendrick*, 81-7317, slip ops. at 3923, 3957 (2 Cir. July 14, 1982). The permissible parameters of a creditor's efforts to seek collection from a debtor are generally those with respect to voidable preferences and fraudulent conveyances proscribed by the Bankruptcy Act; apart from these there is generally no objection to a creditor's using his bargaining position, including his ability to refuse to make further loans needed by the debtor, to improve the status of his existing claims.

Returning to the four principal points raised by objectors, see pp. 8-9, *supra*, we thus think the bankruptcy judge was warranted in giving relatively little weight to those labeled as (a) and (b). The premise of both arguments is that sometime between September of 1974 and May of 1975 the banks knew or had reasonable grounds to believe that Grant was insolvent. Although the Trustee had alleged this in his answer to the banks' claims, we have been cited to no evidence that would support this. To the contrary there was much testimony that Grant continued showing a substantial net worth and that the banks considered it viable almost to the end.

Taking up next the objection lettered (d), the gravamen of this charge is that Grant management, apparently in the summer of 1974, contemplated taking action to place Grant in a Chapter XI proceeding, which might have enabled Grant to survive as a reduced operation with lower administrative expenses, but that the banks prevented this, making specious explanations but acting in reality to improve their preferred position. For this appellants cited passages from two depositions neither of which supports the contention they advance. In the first of

appellants' references, John P. Schroeder, Morgan Guaranty's officer in charge of the Grant credit, merely agreed with questions suggesting that in the late summer of 1974 the banks wished "to recoup the most amount of money as possible on the Grant loans", an understandable and permissible desire, and that for this reason they "did not opt for liquidation at that time". In the second passage cited, Robert Dannenbaum of the Bank of New York stated that at some unspecified time the banks would have liked an "unofficial reorganization program", by which he meant not a Chapter XI proceeding but rather nothing more than "general monitoring of the Company's affairs by the banks". No suggestion is found in any passage of these witnesses' testimony reproduced by appellants that Grant itself actively contemplated undergoing voluntary liquidation or reorganization under the Bankruptcy Act in the summer of 1974. We also note that after July, 1974, the banks increased their loans by \$44,000,000 in August, 1974, and by another \$66,587,500 in October, 1974, and on September 15, 1975, subordinated \$300,000,000 of their debt to trade obligations. While a sinister interpretation is possible, this is not demanded; considering that the fresh money provided by the banks after July, 1974, amounted to some \$226,000,000 as against \$95,378,373 principal amount of the debentures, the banks would have been paying a rather high price to obtain whatever legal advantages the various arrangements of July, 1974, through September, 1975, would yield in the event of Grant's invoking the Bankruptcy Act.

With respect to objection (d), the Bankruptcy Judge was warranted in attaching little importance to general statements by Grant officials that the banks were "running" Grant. There is no doubt that, at least from March

of 1974, the banks kept careful watch on what was going on at Grant; they would have been derelict in their duty to their own creditors and stockholders if they had not. It is not uncommon in such situations for officers whose companies have been brought to the verge of disaster to think that they still have better answers than do the outsiders. In order to establish their claims the appellants must show not simply that the banks proffered advice to Grant that was unpalatable to management, even advice gloved with an implicit threat that, unless it were taken, further loans would not be forthcoming. They must show at least that the banks acted solely for their own benefit, taking into account their reasonable belief that their claims constituted Senior Indebtedness vis-a-vis the debentureholders, and adversely to the interest of others.

The allegation most discussed by appellants is that lettered (c). With respect to this the record, along with materials submitted in support of and in response to the petition for rehearing in *Weinberger v. Kendrick, supra*, enable us to piece out the story. Harry Pierson, the acting president of Grant and Robert Luckett, the controller, made a report to a meeting of the Grant board of directors in June of 1974 proposing a transaction wherein \$100,000,000 of customer accounts receivable would be sold to Beneficial Finance Company (Beneficial) at a discount of up to 27% and some undetermined portion of the proceeds<sup>13</sup> would be used to purchase on the market 4¾% subordinated debentures which were then selling at about 25 cents on the dollar. Pierson reported that two of

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<sup>13</sup> As the transaction was conceived, Grant would use for repurchase of subordinated debentures so much of the proceeds as was needed to have the resulting paper reduction in subordinated debt on the right hand side of Grant's balance sheet offset the loss of assets on the left hand side engendered by the discounted sale of the accounts receivable

the major banks, Morgan Guaranty and Chase, were opposed to the transaction until some time after the completion of the proposed bank loan commitment, presumably the Loan and Guaranty Agreement executed on October 8, 1974. Their reasons were that proceeds of one of Grant's most valuable assets would be used to pay junior debt and that trade creditors would be upset. According to Luckett, Pierson had nevertheless determined to sign the contract with Beneficial and apparently persisted in that intention after a meeting at Morgan Guaranty where the banks' opposition was strongly conveyed. However, when Grant's attorneys received the documents from Beneficial, they found, as often happens in negotiations of this sort, that the provisions were distinctly more onerous than the Grant officers had supposed. For example, Beneficial reserved the right to cull the accounts tendered, would make no payment until 30 days elapsed, and could put back to Grant any accounts that it found difficult to collect. These and numerous other snags in the draft agreement led Charles A. Doyle, then an attorney in Grant's Legal Department, to report to Robert Kelly, his superior, that "it would be legally unwise and unsound to execute any of these agreements in their present form." This view was shared by Kelly, as well as by John Sundman, Grant's new Financial Vice President and its closest link with the banking community.

It would seem a sufficient answer to the objectors that the Beneficial deal was abandoned for reasons relating to its terms that were entirely independent of the banks' opposition. Beyond that we think it would have been surprising if the banks had not objected to the portion of the transaction which involved use of proceeds of quick assets to purchase long-term subordinated debt. The

banks reasonably thought that their claims were senior to the debentures. True, the purchase of debentures at 25 cents on the dollar would have meant a saving of interest of some 19% on the purchase price. But Grant's immediate problem was short term; what it needed was to conserve resources and obtain short-term loans in order to stay afloat until the tide turned. Even if we should assume the evidence went so far, we see nothing inequitable in the banks taking the position that if Grant wished use quick assets to redeem subordinated long-term debt, even on an advantageous basis, it could expect no further help from them.

The appellants raise a special point concerning Chase. As previously stated, Chase, one of the three lead banks, had been Indenture Trustee for the 4¾% debentureholders until August, 1974, when it resigned and was succeeded by U.S. Trust. A debentureholder accepting the offer of settlement releases his claim against both.<sup>14</sup> Despite the limited duties of a trustee for debentureholders, as distinguished from a trustee holding property as security, it is settled in this circuit that he owes a duty "not to profit at the expense of his beneficiary", *Dabney v. Chase Nat'l Bank*, 196 F.2d 668, 670 (2 Cir. 1952) (L. Hand, J.), *as supplemented*, 201 F.2d 635 (2 Cir.), *cert. dismissed per stipulation*, 346 U.S. 863 (1953). See also *United States Trust Co. v. First National City Bank*, 57 A.D.2d 285, 296, 394 N.Y.S.2d 653, 660-61 (1st Dep't 1977), *aff'd*, 45 N.Y.2d 869, 410 N.Y.S.2d 580 (1978); *Broad v. Rockwell Int'l Corp.*, 642 F.2d 929, 959-60 (5 Cir.) (en banc) (construing New York law), *cert. denied*, 454 U.S. 965 (1981); *Morris v. Cantor*, 390 F.Supp. 817, 824 (S.D.N.Y.

<sup>14</sup> We see no basis whatever for any claims against U.S. Trust or its counsel, *supra*, note 12.

1975). When an indenture trustee assumes the role of a lender, it takes the risk that, in the event of insolvency of the issuer, its acts will be subject to special scrutiny. Here the Bankruptcy Trustee conducted an examination of Chase's files covering its activities as indenture trustee, and objector Kurtz deposed a Chase vice president concerning its decision to resign as indenture trustee and other matters. Neither the deposition nor any of the exhibits marked thereat were offered in evidence at the hearing on objections. In their briefs in this court objectors rely on Chase's having played a principal role in the opposition to the sale of accounts receivable to Beneficial Finance Co. and having participated in the negotiation and drafting of the agreements of the summer and fall of 1974.

At first blush the argument that Chase helped to thwart a plan whereby at least some of the debentureholders would have received partial payment might seem to have possible merit. However, it falls on the rock of so much of our previous discussion as shows that Grant would not have consummated the Beneficial deal apart from the banks' opposition. The second argument falters on the fact that the \$44,000,000 of secured loans covered by the Interim Loan and Guaranty Agreement were new money, \$12,480,000 of which was supplied by Chase. Even if the facts showed that Chase participated in negotiation of the October 8, 1974, Loan and Guaranty Agreement while still indenture trustee, which is not at all clear, this also involved \$66,587,500 of new money, \$17,973,000 of which was supplied by Chase. This is some distance from the acts of "[a] creditor who accepts payment of part of a loan before it is due, from a debtor known to be 'fighting for its life', and who insists upon security for the balance [of unsecured debt] when it is due", of which Judge Hand

wrote in *Dabney, supra*, 196 F.2d at 672. As the Fifth Circuit en banc recently concluded, New York authority runs contrary to the assertion "that an indenture trustee has a duty, fiduciary or otherwise, to seek for the holders of debentures any benefits that are *greater* than those contractually due them," *Broad v. Rockwell Int'l Corp., supra*, 642 F.2d at 959 (emphasis in original). In short, while Chase might have been better advised to resign at an earlier date we see little prospect of a recovery against it as indenture trustee on the facts before us.

The only other contention of appellants we deem worthy of discussion is their position that Weil, Gotshal & Manges (WGM) should have been disqualified as attorneys for the Bankruptcy Trustee. Although their argument is cast in terms of disqualification, what appellants are really saying is that WGM's allegiance to the banks led the firm to make an inadequate investigation of the claims of preferences, fraudulent conveyances, and so forth, raised in the Trustee's answer in the adversary proceeding initiated by the banks and, in part because of this lack of investigation, to recommend a settlement too favorable to the banks. The claimed bases for "disqualification" are that:

- (1) WGM acted as counsel for the bank claimants for five days after the initiation of the Chapter XI proceeding and before it was retained as co-counsel by a creditors' committee representing both the bank and other claimants;
- (2) WGM was one of two co-counsel representing the creditors committee throughout the Chapter XI proceeding and until its engagement as counsel for the Trustee in liquidation;

- (3) From February, 1975, until April, 1977, WGM acted as counsel for Morgan Guaranty in connection with a \$9,000,000 claim against Bowmar Instrument Corp. in a Chapter XI proceeding;
- (4) Until 1975, WGM was counsel for Shapiro Brothers Factors Corp., a wholly owned subsidiary of Chase, and it now represents Chase Manhattan Mortgage and Realty Trust, a publicly owned real estate investment trust with ties to Chase.

Judge Galgay overruled this claim, 4 B.R. at 82, partly in reliance on § 44c of the Bankruptcy Act, which provides:

An attorney shall not be disqualified to act as attorney for the receiver or trustee merely by reason of his representation of a general creditor.

Appellants answer that their objection goes to WGM's affiliations not with general creditors but with institutions claiming to be lien creditors.

However, we do not find that any of the relationships charged by appellants were disqualifying. The five days of representation of the bank claimants were *de minimis*; appellants point to no action taken during that period on WGM's advice which figured in the later investigation or negotiations.<sup>15</sup> We likewise have been pointed to no disqualifying action taken while WGM was co-counsel for the creditors' committee in the Chapter XI proceeding. Although appellants allege it was understood that WGM

<sup>15</sup> It would appear that the bank claimants had already acted to set-off \$94,523,110 of Grant's funds on deposit with them and to advance back \$90,300,000 of this amount to Grant as debtor-in-possession by October 2, 1975, prior to the start of WGM's challenged five-day representation of the bank claimants.

was representing the banks and the co-counsel, Ballon, Stoll & Itzler, were representing other creditors, we have been shown nothing to substantiate this or to show that WGM was advancing the cause of the banks in this case. We see no reason to disagree with Judge Galgay's reaffirmation, 4 B.R. at 83, of his conclusion in *In re REA Holding Corp.*, 4 Bankr. Ct. Dec. 1249, 1253 (Bankr. S.D.N.Y. 1979), *vacated and remanded on other grounds*, 2 B.R. 733 (S.D.N.Y. 1980), that "[t]he role of counsel to an official creditors' committee is not adverse to or in conflict with the role of counsel to a bankruptcy trustee if liquidation should subsequently ensue." WGM's previous representation of one or more of the banks or their subsidiaries in unrelated matters is scarcely a ground for disqualification. There is no contention that WGM regularly served any of the banks in bankruptcy cases, and their having done so in one or more unrelated cases would not prevent a vigorous assertion of the claims of the subordinated debentureholders against the banks. On an issue of this sort particular weight should be given to the conclusion of the Bankruptcy Judge, who had abundant opportunities to observe the activities of WGM over many months and concluded "that the Trustee's attorneys have served him and the creditors of the bankrupt estate with vigor, objectivity and independence."

We conclude by reemphasizing that the task of the bankruptcy judge was not to determine whether the settlement was the best that could have been obtained, something that neither he nor we can ever know, but whether it "fall[s] below the lowest point in the range of reasonableness", *Newman v. Stein, supra*, 464 F.2d at 693. If we take the Trustee's estimated realization of \$600,000,000, and deduct the estimated \$143,000,000 of administration and § 64a priority claims, the \$76,000,000

owing to secured suppliers, and the \$24,000,000 owing to senior debentureholders, there would be a balance of \$357,000,000 available for distribution among \$650,000,000 of bank claims, \$95,000,000 of Subordinated Debentures and \$82,000,000 of general unsecured claims, 4 Bankr. Ct. Dec. at 606. If the banks could sustain their claims of subordination, let alone their claims of lien protection for \$288,000,000 of their debt, the subordinated debentureholders would take nothing. Even if the banks' claims to secured creditor status and subordination of the debentures were rejected but the banks were not subordinated to them, all of which was highly problematical, the debentureholders would receive only 43 cents on the dollar, after much further expense. After considering the strengths and weaknesses of the claims of the debentureholders a settlement assuring them of 19 cents can hardly be regarded as below the lowest point in the range of reasonableness.

We therefore affirm the judgment of the district court on the merits.

UNITED STATES DISTRICT COURT  
SOUTHERN DISTRICT OF NEW YORK

-----X  
In re :

W.T. GRANT COMPANY, :

Bankrupt. : 81 Civ.

-----X 5996 (KTD)

DAVID COSOFF, HELEN FINKEL-  
STEIN, EILEEN MCGINNIS, JAY  
MILLER, :

OPINION

Appellants, :

- against - :

CHARLES G. RODMAN, :

Trustee-

Appellee. :

-----X  
APPEARANCES:

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KEVIN THOMAS DUFFY, D.J.:

David Cosoff, Helen Finkelstein, Eileen McGinnis and Jay Miller appeal pursuant to Bankr.R.P. 801 from Bankruptcy Judge Galgay's order approving a settlement between banks and subordinated debentureholders of bankruptcy W.T. Grant Company ("Grant"). The settlement offers debentureholders 19 cents on the collar.<sup>1/</sup> Appellants argue that Judge Glagay committed errors of law and fact in approving the settlement and in providing notice to debentureholders. It is unnecessary, however, to address these arguments. Appellants' claims were litigated to a final judgment in bankruptcy court two years ago, and are thus res judicata.

This matter arises out of the attempt of Grant's bank creditors to collect some \$657,000,000 by enforcing liens and guarantees after the company was adjudicated a bankrupt on April 13, 1976. Appellee Charles G. Rodman, bankruptcy trustee, challenged the validity of the liens and guarantees on

the ground that the banks had obtained their sureties by dominating Grant management to the prejudice of the company in the eighteen months before bankruptcy. Chase Manhattan Bank, N.A., and Citibank, N.A., had been both Grant lenders and indenture trustees for the debentureholders<sup>2/</sup> during the events in question, so these banks appeared to have a conflict of interest. Rodman argued that under the doctrine of equitable subordination the \$94,000,000 in subordinated debentures should be paid in full before the banks received any money from the bankrupt's estate. See Pepper v. Litton, 308 U.S. 295-307-310 (1939).

The trustee accumulated about \$700,000-000 by liquidating the estate. Some \$94,000-000 was set aside to meet the debentureholders' claims in case they won; otherwise the money would go to the banks as senior creditors. The trustee litigated against the banks for about one year. He deposed more than twenty-five witnesses and took more than 10,000 pages of testimony. Settlement nego-

tiations began in late 1977 or early 1978. The trustee recommended a settlement for 14 cents on the dollar, and after five days of hearings in May, 1979, Judge Galgay approved the settlement on February 20, 1980. In re W.T. Grant, 4 Bankr. 53 (Bankr. S.D.N.Y. 1980). The settlement provided that debentureholders would accept a cash payment of 14 cents on the dollar by tendering their securities and waiving all claims against the banks.<sup>3/</sup> Funds would be disbursed out of the \$94,000,000 reserve fund only after 90 percent of the debentureholders (or such lower percentage as the banks would choose) had accepted the offer. The trustee would retain funds sufficient to cover 100 percent of the principal and accrued interest on claims of debentureholders who refused the settlement. The settlement offer would not be distributed to the debentureholders, and no money would be paid out, until appeals of the settlement were exhausted.

Eleven debentureholders appealed from Judge Galgay's order to the district court.

Cosoff, Finkelstein, McGinnis and Miller were not among them. Cosoff and Finkelstein had objected to the settlement in bankruptcy court and had been represented by their present attorney Bradley R. Brewer. Brewer participated in the appeal of Judge Galgay's order, but in his brief he admits that he did not appeal on behalf of Cosoff and Finkelstein because he did not think it necessary to protect their rights.

Negotiations continued while the appeal was pending, and the district court issued a limited remand so that Judge Galgay could supervise the negotiations. On April 1, 1981, the parties reached a compromise; the banks raised their settlement offer to 19 cents on the dollar. In return, the objectants agreed to dismiss their appeal with prejudice. Lawyers for the banks worried that parties not present might try to block the settlement, but Harvey Miller, counsel to the trustee, observed that withdrawal of the appeal would make Judge Galgay's decision final and allow the parties

to disseminate the settlement offer.

Mr. Brewer participated in the settlement conference in Judge Galgay's chambers, but he was unable to state for the record exactly who he was representing. He made no effort to contact his clients to intervene in the appeal or otherwise keep it alive. Mr. Brewer knew of the 19-cent settlement on April 1, 1981, but he received no objection from any client to the offer by June 8, when he was informed that all objections to the new settlement had to be submitted to the bankruptcy court in writing by June 12. Mr. Brewer submitted no written objections because he had received none by that date. Judge Galgay approved the 19-cent settlement on June 16. Mr. Brewer appeared at the hearing on June 16, but he was still uncertain as to who he represented. Only Mr. Cosoff had retained him to oppose the settlement, and Mr. Cosoff had acted on June 13, one day after the deadline for submitting objections. Judge Galgay gave Mr. Brewer a limited time to argue in court against the settle-

ment. Mr. Brewer chose to object only to the adequacy of notice--he claimed the June 8-12 interval was too little time, and he claimed the notice of settlement was confusing--and to attorneys' fees incorporated in the settlement.<sup>4/</sup>

The settlement offer was distributed, and about \$79,300,000 or 80 percent of the debentures have been exchanged in acceptance of the settlement. The banks approved disbursement of cash pursuant to the settlement.<sup>5/</sup> It is this executed settlement<sup>6/</sup> that appellants, again represented by Brewer,<sup>7/</sup> seek to undo.

Two years after the bankruptcy court approved the 14-cent settlement, appellants here raise only the same claims that were litigated before Judge Galgay. Judge Galgay's decision was res judicata. Katchen v. Landy, 382 U.S. 323, 334 (1966). Even though the bankruptcy proceeding continued, appellants could attack the decision only by direct appeal. In re Abilene Flour Mills Co., 439 F.2d 937, 939 (10th Cir. 1971); Kimm v. Cox, 130 F.2d

721, 736-37 (8th Cir. 1942). This they failed to do. Therefore, they may not litigate their claims a second time through this appeal.

Appellants argue that Judge Galgay's decision was challenged on appeal by the original objectants. They reason that because they were not parties to the first appeal, the dismissal of the appeal does not bind them and in some way reopens Judge Galgay's decision to their attack. This argument mistakes the effect of res judicata in bankruptcy.

A bankruptcy is essentially an in rem proceeding of an equitable nature. Local Loan Co. v. Hunt, 292 U.S. 234, 241 (1934); Moore, Res Judicata and Collateral Estoppel in Bankruptcy, 68 Yale L.J. 1, 1 (1958); 1 Collier on Bankruptcy, ¶2.09, at 173 & n.3 (J. Moore & L. King 14th ed. 1974). The bankruptcy court adjudicates interests in the res, which is the bankrupt's estate in general and the \$94,000,000 reserve fund in this particular case. A judgment in rem binds all parties in the world who have notice of the proceeding as to their interests in the res.<sup>8/</sup> Restatement of Judgments

Section 73(1) (1942); Restatement (Second) of Judgments, Section 73(a) & Comment (a) at 192 (Tent. Draft No. 1 1973).

In Stoll v. Gottlieb, 305 U.S. 165 (1938), the bankruptcy court approved over creditor Gottlieb's protests a reorganization plan which required Gottlieb and other creditors to give up their claims against guarantors of the debtor. Gottlieb did not appeal the bankruptcy court's decision that it had jurisdiction to bind Gottlieb as against the guarantor, and the Supreme Court held the decision res judicata against Gottlieb when he sued the guarantor in state court.

In Chicot County Drainage Dist. v. Baxter State Bank, 308 U.S. 371 (1940), the bondholders with notice of a municipal bankruptcy proceeding but who never participated in the proceeding challenged the bankruptcy court's adjudication after the Supreme Court, in another case, held the municipal bankruptcy law unconstitutional. The bondholders argued the bankruptcy court lacked subject mat-

ter jurisdiction. Even though the bondholders never participated in the proceeding, the Court held the decision of the bankruptcy court res judicata. Id. at 375. See Moore, supra, 68 Yale L.J. at 7-10.

The cases as analyzed above indicate that a creditor with notice may not contest a decision of the bankruptcy court once that decision has become final, whether or not the creditor appeared before the bankruptcy judge. It would seem to follow that a creditor may not contest a decision of the bankruptcy court on appeal after a first appeal has been withdrawn and the time to join in that appeal has expired. See Bankr.R.P. 802(a).<sup>9/</sup> It is not the capitulation of the original appellants which binds the appellants here. See Robinson v. First Nat'l City Bank, 482 F. Supp. 92 (S.D.N.Y. 1979) (litigating creditors in bankruptcy are not class representatives and do not bind fellow creditors). It is instead appellants' own failure to join in the original appeal.

To allow appellants a second chance at review would permit yet a third appeal should these appellants settle with the banks. A decision permitting such a result would disserve the goal of finality in litigation which is the purpose of res judicata. See Federated Department Stores, Inc. v. Moitie, 49 U.S.L.W. 4687 (1981) (where five of six plaintiffs dismissed by the same judge won on appeal because of an intervening change in law, the district court decision remained res judicata against the non-appealing plaintiff). Moreover, appellants present no good reason for relief from res judicata. The first appeal was not a sham; no procedural inequity is apparent.<sup>10/</sup> Nor will any substantive injustice result from this application of res judicata. The settlement appellants seek so hard to upset explicitly preserves to them and all other dissenting debentureholders both their cause of action against the banks and a reserve fund from which to collect. In any event, this appeal is totally devoid of merit. Judge Galgay care-

45a

fully considered the settlement over six days of hearings, and the opinion of the court, though drawn from the statement of the trustee, contains no error sufficient to constitute an abuse of discretion.

The order of the bankruptcy court is affirmed and costs will be assessed against the appellants.

SO ORDERED.

Dated: New York, New York  
March 15, 1982

/s/ KEVIN THOMAS DUFFY, U.S.D.J.

FOOTNOTES

1. The settlement actually provides for a gross payment of 21 cents on the dollar; it provides that no more than 2 cents on the dollar will go towards attorneys' fees, leaving debentureholders with a net settlement of at least 19 cents on the dollar.
2. There are actually two different groups of debentureholders in this proceeding: those holding 4.75 percent subordinated debentures totalling \$92,507,000, and those holding 4 percent subordinated debentures totalling \$834,000. Citibank was the indenture trustee for the 4-percent debenture holders; Chase Manhattan was the indenture trustee for the 4.75 percent debentureholders until August 14, 1974, when it resigned and was replaced by the United States Trust Company of New York. Appellants here hold only 4.75 subordinated debentures. Because I hold that Judge Galgay's 1980 decision is res judicata against all subordinated debentureholders, I do not consider appellee's argument that appellants cannot affect the validity of the settlement on behalf of the 4-percent holders.
3. The first settlement provided for a gross payment of 15 cents on the dollar, with no more than 1 cent going towards attorneys' fees.
4. Appellants arguably failed to preserve their claims for appeal by not properly articulating or presenting them in the bankruptcy court. In *re* REA Holding Corp., 2 Bankr. 733, 737 (S.D.N.Y. 1980); In *re* Bildisco, 11 Bankr. 1019, 1020 (D.N.J. 1981). Appellee in turn first presented his res judicata argument in this appeal. However- neither side contends here that the other has waived a claim or defense by failing to present it to the bankruptcy court. Omission of res judicata arguments below is understandable: Mr. Brewer's failure to comply with the bankruptcy court's procedures deprived the trustee of notice that a res judicata defense would be necessary. For this reason, and in the absence of any waiver argument by appellants, I think appellee's res judicata argument is properly before this Court. To rule otherwise would reward appellants for their failure to comply with procedures below.

5. Appellants tried and failed to obtain a stay of the cash disbursement. The banks guaranteed return of the case should this appeal go against them.
6. Cf. Bankr.R.P. 805 (Unless an order approving sale of property is stayed pending appeal, a good faith purchaser of the property shall not be affected by reversal or modification of the order).
7. The notice of appeal was filed by Mr. Brewer. Mr. Eaton later appeared as co-counsel for the appellants.
8. The appellants do not claim that they lacked notice of the bankruptcy proceeding.
9. See 9 Moore's Federal Practice, ¶204.11[4] at 4-54-55 (J. Moore, B. Ward & J. Lucas 2d ed. 1980) (though parties may have identical interests, one who appeals under Fed.R.App.P. 4(a) does not stand as surrogate for one who does not, and those failing to appeal may not challenge judgment of the trial court). Bankr. R.P. 802(a) is modeled after Fed.R.App. 4(a). Bankr. R.P. 802 advisory committee note.
10. Appellants complaint that they recieved no notice of the original appellants' decision to withdraw their appeal with prejudice. This argument contains neither legal nor factual merit. The present appellants had knowledge of the original order and could have joined in the original appeal. Withdrawal of the appeal occurred long after the appellants' time to join the appeal had lapsed. It is settled law that appellants were owed no notice of the order from which appeal was taken. See In re General Insecticide Co., 403 F.2d 629, 630 (2d Cir. 1968); In re St. Cloud Tool & Die Co., 533 F.2d 387, 390 (8th Cir. 1976). It is difficult to see how appellants were owed notice of a withdrawal of an appeal if they were not owed notice of the original order. Finally, Mr. Brewer, who admits in his brief that he represented appellants before the bankruptcy court, did have notice of the decision to withdraw the first appeal.

JUL 5 1985

ALEXANDER L. STEVENS,  
CLERK

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IN THE  
**Supreme Court of the United States**

OCTOBER TERM, 1982

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No. 82-1985

In re  
W. T. GRANT COMPANY,

*Bankrupt.*

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DAVID COSOFF and HELEN FINKELSTEIN,

*Petitioners,*

*-against-*

CHARLES G. RODMAN, as Trustee of the  
Estate of W. T. GRANT COMPANY, Bankrupt,

*Respondent.*

---

ON PETITION FOR A WRIT OF CERTIORARI TO THE  
UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

---

**RESPONDENT'S BRIEF IN OPPOSITION TO  
PETITION FOR A WRIT OF CERTIORARI**

---

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IN THE  
**Supreme Court of the United States**  
October Term, 1982

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No. 82-1985

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In re  
W. T. GRANT COMPANY,

*Bankrupt.*

---

DAVID COSOFF and HELEN FINKELSTEIN,

*Petitioners,*

*-against-*

CHARLES G. RODMAN, as Trustee of the  
Estate of W. T. GRANT COMPANY, Bankrupt,

*Respondent.*

---

ON PETITION FOR A WRIT OF CERTIORARI TO THE  
UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

---

---

**RESPONDENT'S BRIEF IN OPPOSITION TO  
PETITION FOR A WRIT OF CERTIORARI**

---

**Opinions Below**

The order of the United States Court of Appeals for the Second Circuit (the "Second Circuit"), dated January 26, 1983, is reported at 699 F.2d 599, and the slip opinion is reprinted in Petitioners' Appendix. (Petitioners' Appendix ("P. App.") at 3a). The order of the Second Circuit affirmed an order of the United States District Court for the Southern District of New York (the "District Court"), dated March 15, 1982, which is reported at 20 B.R. 186 and reprinted from the slip opinion in Petitioners' Appendix (P. App. at 34a). The order of the District Court affirmed an order of the United States Bankruptcy Court for the Southern District of

New York (the "Bankruptcy Court"), dated June 23, 1981 (Respondent's Appendix ("R. App.") at 1a),<sup>1</sup> which supplemented and amended a prior order of the Bankruptcy Court, dated February 20, 1980. The prior order of the Bankruptcy Court is reported at 4 B.R. 53 and reprinted in Respondent's Appendix (R. App. at 5a).

### **Jurisdiction**

Although Petitioners<sup>2</sup> state that jurisdiction is invoked under 28 U.S.C. §1254(1), presumably Petitioners also invoke jurisdiction under Section 24c of the former Bankruptcy Act, 11 U.S.C. §47c.<sup>3</sup>

### **Question Presented**

Did the approval by the Bankruptcy Court of the offer of compromise and settlement of a pending controversy with holders of the bankrupt's convertible subordinated debentures, as affirmed by the District Court and the Second Circuit, constitute an abuse of discretion or plain error of law?

### **Statement of the Case**

The case arises out of the bankruptcy of W. T. Grant Company ("Grant"). On October 2, 1975, the date of bankruptcy, Grant's liabilities exceeded one billion dollars, inclusive of two issues of publicly owned and outstanding Convertible Subordinated Debentures. One issue of such Convertible Subordinated Debentures, the 4% Debentures, had an aggregate outstanding principal balance of \$834,000 and was held by an estimated 128 Debentureholders. (R. App. at 8a). The other

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<sup>1</sup>By order dated June 30, 1981, the Bankruptcy Court corrected its June 23, 1981 order for technical errors. R. App. contains the June 23, 1981 order as corrected.

<sup>2</sup>Petitioners are joint holders of W. T. Grant Company 4¼% Convertible Subordinated Debentures in the principal amount of \$150,000.

<sup>3</sup>On November 6, 1978, Congress enacted the Bankruptcy Reform Act of 1978, replacing the Bankruptcy Act with the new Bankruptcy Code. The Bankruptcy Act, not the new Bankruptcy Code, is applicable to this case. See Bankruptcy Reform Act of 1978, tit. IV, § 403(a), 92 Stat. 2683.

issue of Convertible Subordinated Debentures, the 4¾% Debentures, had an outstanding principal balance of \$92,507,000, and as at March 15, 1979, there were 2,315 registered holders. (R. App. at 8a).

As provided in the indentures pursuant to which the Debentures were issued and as stated in the Debentures, the Debentures represent subordinated indebtedness, subject in right of payment to the prior payment in full of all Senior Indebtedness as defined in the indentures. (P. App. at 11a-12a; R. App. at 8a-9a, 31a-32a). Full enforcement of the contractual subordination provisions in the face of the total indebtedness and liabilities of Grant constituting Senior Indebtedness, inclusive of indebtedness to Grant's bank creditors ("Bank Claimants"), would result in no recovery by the Subordinated Debentureholders from the assets of the bankrupt estate. (P. App. at 12a; R. App. at 11a). As a consequence, a controversy developed in the bankruptcy case in which it was contended that the Bank Claimants had assumed a position of control and domination over Grant to the detriment and prejudice of Grant and the Debentureholders which vitiated the contractual subordination provisions of the Debentures and the indentures. The essence of the assertions is that the claims of the Bank Claimants should be equitably subordinated to the claims of the Debentureholders. (P. App. at 12a-13a; R. App. at 11a-14a).

Charles G. Rodman, as Trustee of the Grant estate (the "Trustee"), conducted an extensive investigation of the affairs of Grant, including the review and analysis of thousands of pages of documents and the taking of depositions of more than twenty-five individuals aggregating at least 10,000 pages, and concluded that it was probable that the Debentureholders' equitable subordination claims would fail if such claims were to be litigated. (P. App. at 10a, 36a-37a; R. App. at 5a-6a, 30a, 38a, 44a, 46a). This is the same conclusion reached by the attorneys for holders of Grant's securities in a class action litigation against the Bank Claimants. See *Weinberger v. Kendrick*, 698 F.2d 61, 67 (2d Cir. 1982), *petition for cert. filed sub nom. Lewy v. Weinberger*, 51 U.S.L.W. 3859 (May 17, 1983).

However, in the effort to avoid the substantial costs and delays of the necessarily complex, protracted and expensive litigation that might have resulted, the Trustee negotiated with the parties in interest in the effort to reach an amenable resolution of the controversy. Thereafter, the Trustee was authorized to propose a compromise and settlement of the claims of the Debentureholders by the payment to each accepting Debentureholder of a gross amount of fifteen percent (15%) of each Debenture tendered in acceptance of the offer, subject to certain costs. This original proposed offer of compromise and settlement was approved by the Bankruptcy Court after a six-day hearing by order of February 20, 1980. (P. App. at 14a-15a, 36a-37a, 46a; R. App. at 19a-22a).

Certain Debentureholders appealed to the District Court from the Bankruptcy Court's order of February 20, 1980. After the appeal had been pending for an extended period of time and it appeared that no final resolution was imminent, negotiations were reopened among the parties in interest to resolve the controversy. (P. App. at 15a-17a, 37a-38a). The result was an amended offer of compromise and settlement (the "Amended Offer") which is identical to the original offer in all material respects except that it increases the gross payment to accepting Debentureholders to twenty-one percent (21%) of the principal amount of each Debenture tendered in acceptance of the offer.<sup>4</sup> This gross payment is subject to reduction by a *pro rata* share of certain fees and expenses as may be allowed by the Bankruptcy Court, with a net payment of not less than nineteen percent (19%) of the principal amount of each tendered Debenture. (P. App. at 16a, 35a, 46a). The Amended Offer reserves to non-accepting Debentureholders whatever rights they may have to pursue without prejudice any claims they may possess under or relating to their Debentures. (P. App. at 18a, 44a; see P. App. at 14a; R. App. at 21a-22a).

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<sup>4</sup>The increase essentially results from the addition of the interest which would have been earned if the original gross settlement amount had been deposited on the original approval date.

The Amended Offer was approved by the Bankruptcy Court by order dated June 23, 1981. Petitioners, among others, appealed to the District Court and the Second Circuit, and in each instance the Bankruptcy Court's approval of the Amended Offer was affirmed. During the pendency of the appeals, the Trustee, as authorized by the terms of the Amended Offer, distributed the offer to all record holders of Debentures. (P. App. at 16a, 40a). To date, approximately ninety-five percent (95%) in principal amount of the Debentures have been tendered in acceptance of the Amended Offer.<sup>5</sup>

In the Petition, Petitioners make the same specious-arguments which were litigated and rejected in connection with the original offer before the Bankruptcy Court and which Petitioners revived in the proceedings before the Bankruptcy Court, the District Court and the Second Circuit concerning the Amended Offer. (E.g., P. App. at 24a, 31a, 40a). These arguments are premised upon the belief that each of the lower courts misconstrued and improperly evaluated the factual circumstances surrounding Petitioners' equitable subordination claims.

Because Petitioners' arguments are factual in nature, the Petition presents no issue which is appropriate for review by this Court. Traditionally, the Court has declined to grant a petition for certiorari when the matters presented depend upon an interpretation of the evidence. In addition, this case involves no conflict among the courts of appeal or important and unsettled issue of federal law. The controversy arises in the context of a compromise and settlement under the former Bankruptcy Act. The task of the lower courts was not to decide Petitioners' claims on the merits but to determine whether the compromise and settlement is fair and reasonable in light of all of the circumstances. (P. App. at 15a, 20a-21a,

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<sup>5</sup>The Second Circuit noted that the Amended Offer had been accepted by holders of approximately eighty percent (80%) in principal amount of the Debentures. (P. App. at 17a). Subsequent to the tabulation by the Second Circuit, the Amended Offer has been accepted by holders of approximately fifteen percent (15%) in principal amount of the Debentures.

32a, 44a-45a; R. App. at 29a-50a). In this context, the three lower courts thoroughly analyzed all of the claims presented, and their findings and conclusions should not be disturbed.

### **Statement of Facts**

Petitioners' version of the facts of this case contains a multitude of errors and mischaracterizations and is based in large part upon patently biased speculation and conjecture. The extent of Petitioners' distortion of the record may be demonstrated by a comparison with the detailed findings of fact set forth in the decisions of both the Bankruptcy Court (R. App. at 5a) and the Second Circuit (P. App. at 3a).

The Bankruptcy Court considered (a) the testimony of witnesses presented at six days of hearings that consumed almost 1,000 pages of stenographic transcript, (b) pre-hearing depositions of the Trustee and others, (c) the introduction into evidence of eighty exhibits aggregating at least 15,000 pages, including stenographic transcripts of depositions of more than twenty-five individuals, and (d) hundreds of pages of memoranda of law (R. App. at 5a-7a, 30a, 38a, 42a-44a, 46a, 57a). Both the District Court and the Second Circuit independently reviewed the record presented to the Bankruptcy Court and found no error on the part of the Bankruptcy Court.

### **No Basis Exists for the Issuance of a Writ of Certiorari**

Petitioners fail to assert a single credible basis for granting their petition. (Petitioners' Brief at 31). Basically, Petitioners complain of two errors by the courts below: (a) the conclusion of the lower courts that the Amended Offer is fair and reasonable notwithstanding Petitioners' allegations that the conduct of the Bank Claimants mandates equitable subordination of their claims vis-a-vis the Debentureholders, and (b) the conclusion of the lower courts that Petitioners'

allegations as to a conflict of interest on the part of the Trustee's attorneys are lacking in merit.<sup>6</sup> The Petitioners' contentions are specious and nothing more than a patent effort to further delay the receipt of over \$17,000,000 by Debentureholders who have waited over three years for their distributions.

#### A. Equitable Subordination

The considerations governing review on certiorari set forth in Supreme Court Rule 17.1, though not limiting the discretion of the Court, support the denial of the petition for certiorari. No conflict exists between the Second Circuit's decision and the decisions of this Court or other courts of appeal concerning the application of the doctrine of equitable subordination in the context of bankruptcy cases. The principles of equitable subordination enunciated by the Bankruptcy Court (R. App. at 38a-44a), and adopted without quarrel by the Second Circuit (P. App. at 23a), are drawn from the prior decisions of this Court and those of various courts of appeal. *E.g.*, *Comstock v. Group of Institutional Investors*, 335 U.S. 211 (1948); *In re Mobile Steel Company*, 563 F.2d 692 (5th Cir. 1977); *In re Branding Iron Steak House*, 536 F.2d 299 (9th Cir. 1976); *Farmers Bank of Clinton v. Julian*, 383 F.2d 314 (8th Cir.), *cert. denied*, 389 U.S. 1021 (1967); *Rader v. Boyd*, 252 F.2d 585 (10th Cir. 1957); *In re Prima Co.*, 98 F.2d 952 (7th Cir.), *cert. denied sub nom. Keig v. Harris Trust & Savings Bank*, 305 U.S. 658 (1938); *In re Bowman Hardware & Electric Co.*, 67 F.2d 792 (7th Cir. 1933); *In re Process-Manz Press, Inc.*, 236 F. Supp. 333 (N.D. Ill. 1964), *rev'd on jurisdictional grounds*, 369 F.2d 513 (7th Cir. 1966), *cert. denied sub nom. Limperis v. A. J. Armstrong Co., Inc.*, 386 U.S. 957 (1967). Moreover, decisions concerning equitable subordination which have been rendered by courts of appeal since the Bankruptcy Court's decision apply and state the principle of law in a manner consistent with the orders of the Second Circuit and the Bankruptcy Court. *In re*

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<sup>6</sup>At various stages of the proceedings below, the objecting Debentureholders also attacked the ethics of the Trustee, the Indenture Trustee for the 4¾% Debentures and the attorneys for said Indenture Trustee. (R. App. at 50a-57a).

*Westgate-California Corp.*, 642 F.2d 1174 (9th Cir. 1981); *In re Multiponics*, 622 F.2d 709 (5th Cir. 1980).

Similarly, the Petition raises no important question of federal law with respect to equitable subordination which has not already been, but should be, settled by this Court. While the doctrine of equitable subordination is itself of general significance, the issue presented by this case is not whether equitable subordination should operate to vitiate the subordination provisions of the Debentures and the indentures pursuant to which the Debentures were issued, but whether the Bankruptcy Court, after a full and informed appraisal of the facts, abused its discretion or committed a plain error of law in determining that the compromise and settlement embodied in the Amended Offer is fair and reasonable. This point was emphasized by the Second Circuit:

In undertaking an examination of the settlement, we emphasize that this responsibility of the bankruptcy judge, and ours upon review, is not to decide the numerous questions of law and fact raised by appellants but rather to canvass the issues and see whether the settlement "fall[s] below the lowest point in the range of reasonableness", *Newman v. Stein*, 464 F.2d 689, 693 (2 Cir.), *cert. denied sub nom. Benson v. Newman*, 409 U.S. 1039, 93 S.Ct. 521, 34 L.Ed.2d 488 (1972).

(P. App. at 20a-21a; *see* P. App. at 32a).

In making their determinations, the Bankruptcy Court and the Second Circuit noted compliance with the principle of *Protective Committee for Independent Stockholders of TMT Trailer Ferry, Inc. v. Anderson*, 390 U.S. 414, 424 (1968), even though Grant is a liquidating bankruptcy case and not a reorganization case. The lower courts evaluated not only the probabilities of success of Petitioners' claims of equitable subordination if such claims were to be litigated on the merits, but also the "complexity, expense and likely duration of any such litigation . . . and all other factors relevant to a full and fair assessment of the wisdom of the proposed compromise." (P. App. at 15a; R. App. at 29a-50a). Accordingly, the Petition presents no issue of general importance or application of diverse legal principles which should be settled by this Court, but rather seeks to have the Court resolve what is

essentially a private dispute of "isolated significance" despite review by three courts. As was stated by this Court in *Layne & Bowler Corp. v. Western Well Works, Inc.*, 261 U.S. 387, 393 (1923):

[I]t is very important that we be consistent in not granting the writ of certiorari except in cases involving principles the settlement of which is of importance to the public as distinguished from that of the parties, and in cases where there is a real and embarrassing conflict of opinion and authority between the circuit courts of appeal. The present case certainly comes under neither head.

Not only does this case present no unsettled and important question of law, but it is clear that Petitioners' real complaint as to the decisions below concerns only issues as to questions of fact regarding the equitable subordination claims and their disagreement with the lower courts' evaluation of the factual issues. As stated above, the Bankruptcy Court conducted a thorough and detailed investigation regarding the relative status of the claims of the Debentureholders and the Bank Claimants, the conduct of the Bank Claimants in protecting their loans to Grant, and other matters relevant to the equitable subordination claims. The District Court and the Second Circuit independently reviewed the record. In each instance, the lower courts affirmed the determinations of the Bankruptcy Court and rejected Petitioners' convoluted interpretation of the facts.

This Court has traditionally denied certiorari when a court of appeals decision turns upon an analysis of the facts. As Justice Holmes wrote in *United States v. Johnston*, 268 U.S. 220, 227 (1925):

We do not grant a certiorari to review evidence and discuss specific facts.

*Accord, General Talking Pictures Corp. v. Western Electric Co.*, 304 U.S. 175, 178 (1938) ("Granting of the writ would not be warranted merely to review the evidence or inferences drawn from it"). In *National Labor Relations Board v.*

*Pittsburgh Steamship Co.*, 340 U.S. 498, 503 (1951), the Court said that courts of appeal are courts of last resort as to matters of fact, even when the evidence might admit of varying interpretations:

This is not the place to review a conflict of evidence nor to reverse a Court of Appeals because were we in its place we would find the record tilting one way rather than the other, though fair-minded judges could find it tilting either way. It is not for us to invite review by this Court of decisions turning solely on evaluation of testimony where on a conscientious consideration of the entire record a Court of Appeals under the new dispensation finds the Board's order unsubstantiated. In such situations we should "adhere to the usual rule of noninterference where conclusions of Circuit Courts of Appeals depend on appreciation of circumstances which admit of different interpretations." *Federal Trade Comm'n v. American Tobacco Co.*, 274 U.S. 543, 544.

*Accord*, *Federal Trade Commission v. Standard Oil Co.*, 355 U.S. 396, 400-01 (1958). In the perspective of the foregoing, Petitioners' refusal to accept the findings and conclusions of three lower courts is not a sufficient basis for the granting of a petition for certiorari.

#### **B. Conflict of Interest**

Petitioners' second asserted error by the courts below concerns an alleged conflict of interest of the Trustee's attorneys. As to this issue, there is likewise no conflict between the Second Circuit's decision and the decisions of this Court and other courts of appeals. In *Pepper v. Litton*, 308 U.S. 295, 299 n.4 (1939), the sole authority cited by Petitioners, this Court denounced the retention by a trustee in bankruptcy of an attorney who had previously served as attorney for the bankrupt. The circumstances of the instant case are totally dissimilar. During the pendency of Grant's aborted Chapter XI case, the Trustee's attorneys represented the Creditors' Committee of Grant and at no time represented the bankrupt itself or any individual creditor as to

its claim against Grant. Accordingly, *Pepper v. Litton* presents no conflict with the decision of the Second Circuit.

The purported conflict of interest of the Trustee's attorneys raises no important issue of federal law which has not been, but should be, settled by this Court, and the matter is fully dealt with in the Second Circuit's decision. Further, any issues as to section 44c of the former Bankruptcy Act, 11 U.S.C. § 72c, which permitted a trustee in bankruptcy to engage attorneys who had previously represented a "general creditor", are now academic because of the enactment of the Bankruptcy Reform Act of 1978, which includes title 11 of the United States Code (the "Bankruptcy Code"). Section 327(c) of the Bankruptcy Code permits a trustee to engage attorneys who have previously represented any creditor.<sup>7</sup> Since the new Bankruptcy Code applies to all bankruptcy cases commenced on or after October 1, 1979,<sup>8</sup> Petitioners' quarrel with the terminology of section 44c of the former Bankruptcy Act will not arise again in the future.<sup>9</sup> An issue which arises under a superceded statute, particularly where the new statute resolves the controversy, does not merit consideration by this Court. *E.g.*, *District of Columbia v. Sweeney*, 310 U.S. 631 (1940) (certiorari denied "in view of the fact that the tax is laid under a statute which has been repealed and the question is therefore not of public importance."); *see also Rice v. Sioux City Memorial Park Cemetery, Inc.*, 349 U.S. 70, 76-77 (1955) (writ of certiorari

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<sup>7</sup>Section 327(c) of the Bankruptcy Code, which pertains to the employment of professionals by a trustee, provides as follows:

In a case under chapter 7 or 11 of this title, a person is not disqualified for employment under this section solely because of such person's employment by or representation of a creditor, but may not, while employed by the trustee, represent, in connection with the case, a creditor.

<sup>8</sup>See note 1 *supra*.

<sup>9</sup>Section 327(c) of the Bankruptcy Code also specifically overrules Bankruptcy Rule 219(c). *See* Bankruptcy Reform Act of 1978, tit. IV, § 405(d), 92 Stat. 2685.

dismissed due to enactment of statute which rendered the case of "isolated significance").

Petitioners' remaining contentions regarding the alleged conflict of interest concern interpretations of the facts. As stated above, evaluations of the evidence are not appropriate for Supreme Court review. The Bankruptcy Court, which had an opportunity to observe the activities of the Trustee's attorneys during an extended period of time, concluded "that the Trustee's attorneys have served him and the creditors of the bankrupt estate with vigor, objectivity and independence." (R. App. at 55a). The Second Circuit expressed its approval of the Bankruptcy Court's finding (P. App. at 32a), and no further consideration by this Court is warranted. Thus it is manifest that no reason exists for granting of a petition for certiorari in this case.

#### **The Petition Is Frivolous and Damages and Double Costs Should Be Awarded to Respondent**

Section 1912 of title 28, United States Code, provides that where a judgment is affirmed by this Court or a court of appeals, the court in its discretion may "adjudge to the prevailing party just damages for his delay, and single or double costs."<sup>10</sup> E.g., *National Labor Relations Board v. Catalina Yachts*, 679 F.2d 180, 182 (9th Cir. 1982) (double costs and attorneys' fees awarded for frivolous appeal); *Browning Debenture Holders' Committee v. DASA Corp.*, 605 F.2d 35, 40-41 (2d Cir. 1978) (double costs and damages awarded for appeal taken in bad faith); *Teledyne Industries, Inc. v. Podell*, 546 F.2d 495 (2d Cir. 1976) (double costs and attorneys' fees awarded for appeal which was without merit and frivolous); *Acevedo v. Immigration and Naturalization Service*, 538 F.2d 918 (2d Cir. 1976) (double costs taxed personally against petitioner's counsel for frivolous and meritless

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<sup>10</sup> Although denial of the Petition would not affirm the judgment below, in *Deming v. Carlisle Packing Co.*, 226 U.S. 102 (1912), the Court, in construing the predecessor statute of section 1912, held that a dismissal of a writ of error is equivalent to a judgment of affirmance for purposes of awarding damages for frivolous delay.

petition interposed as a delaying tactic). This provision is complemented by Supreme Court Rule 49.2 which states that when a petition for writ of certiorari is frivolous, the Court may award appropriate damages to the respondent. *E.g.*, *Tatum v. Regents of the University of Nebraska-Lincoln*, 51 U.S.L.W. 3883 (June 13, 1983). The Trustee submits that such damages, including attorneys' fees, expenses and double costs, are appropriate here.

The Grant bankruptcy proceedings have been pending for more than seven years, and the Trustee's original offer of compromise and settlement to Debentureholders was approved by the Bankruptcy Court nearly three and one-half years ago. The Amended Offer, which is the subject of the petition for certiorari, was approved by the Bankruptcy Court approximately two years ago. During this entire period, Debentureholders have received nothing in respect of their claims against the bankrupt estate, despite overwhelming acceptance of the Amended Offer by holders of approximately ninety-five percent (95%) in principal amount of the Debentures. Petitioners filed their petition for certiorari on the last day of the period within which a petition for certiorari could be filed. Patently, the Petition was an attempt to frustrate other Debentureholders as to the orderly judicial process of settling and paying claims in bankruptcy. It is pure malevolence and spite on the part of Petitioners and their attorney. Presumably, they hope to leverage the Trustee and the Bank Claimants to "buy them out" with an increased offer. Petitioners simply are using this Court to further wholly selfish aims despite the harm and prejudice to the hundreds of Debentureholders who have accepted the Amended Offer.<sup>11</sup>

Holders of 4¾% Debentures in the aggregate principal amount of \$88,029,000 (approximately 95.16% of the principal amount outstanding) and holders of 4% Debentures in the aggregate principal amount of \$735,000 (approximately 88.13% of the principal amount outstanding) have

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<sup>11</sup>As noted by the Second Circuit, the standing of Petitioners is dubious. Non-accepting Debentureholders retain any rights they may have against the Bank Claimants or any other person or entity. (P. App. at 18a-19a).

tendered their Debentures in acceptance of the Amended Offer. As stated above, Petitioners may litigate their claims as to equitable subordination and any other matters relating to their Debentures at any time. Instead, Petitioners have extended their protracted litigation, to the prejudice and detriment of other Debentureholders, despite no prejudice to their claims.

The Petition is a frivolous delaying tactic. It is an abuse of the judicial system which should not be countenanced, and damages should be awarded in favor of the respondent.

### Conclusion

The petition for a writ of certiorari to the United States Court of Appeals for the Second Circuit should be denied in all respects, and damages and double costs should be awarded to the respondent.

Dated: New York, New York  
July 1, 1983

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*Of Counsel.*

## APPENDIX

UNITED STATES DISTRICT COURT  
SOUTHERN DISTRICT OF NEW YORK

—In re—

W. T. GRANT COMPANY,

Bankrupt.

Bankruptcy No.  
75 B 1735

ORDER AUTHORIZING AND APPROVING AMENDED  
OFFER OF COMPROMISE AND SETTLEMENT TO  
HOLDERS OF 4% AND 4¾% CONVERTIBLE  
SUBORDINATED DEBENTURES OF  
W. T. GRANT COMPANY

Upon the hearing held on June 16, 1981 ("Hearing"), after due notice pursuant to the order dated June 5, 1981, to consider the application of Charles G. Rodman, as Trustee of the Estate of W. T. Grant Company, Bankrupt ("Trustee"), dated June 5, 1981 (the "Application"), for an order (1) authorizing and approving an amended offer of compromise and settlement of the claims of holders of the Bankrupt's 4¾% Convertible Subordinated Debentures due 1996 and the 4% Convertible Subordinated Debentures due 1990 (the "4¾% Debentures" and the "4% Debentures," respectively, sometimes hereinafter collectively referred to as the "Debentures") (the "Amended Offer") against the bankrupt estate, as described in the Application and the Statement of Terms of Compromise and Settlement annexed to the Application as Exhibit B ("Statement"), and (2) authorizing the dissemination of the Amended Offer to the Holders of the Debentures in the manner described in the Application; and the appearances of parties in interest having been noted in the record and upon the evidence admitted at the Hearing, the record of the hearing held in connection with the Trustee's application dated April 18, 1979 to authorize and approve the initial proposed offer of compromise and settlement of the aforesaid claims of the holders of Debentures ("Initial Proposed Offer") and all of the proceedings had before the court including but not limited to the statement of Bradley Brewer,

Esq., as attorney for David Cosoff, an asserted holder of less than \$100,000 of principal amount of 4¾% Debentures, the prior decision of the court granting the Trustee's application dated April 18, 1979, *In re W. T. Grant Company*, 4 B.R. 53 (1980) (the "Decision") and the orders and stipulations withdrawing appeals from the Decision, with prejudice, dated April 16 and April 20, 1981, respectively, and filed with the United States District Court for the Southern District of New York and after due consideration and sufficient cause appearing therefor, it is

ORDERED, ADJUDGED, DECREED AND DETERMINED:

1. The Application and Hearing clearly and distinctly demonstrate the reasons why the Amended Offer is in the best interest of the bankrupt estate and all of its creditors.

2. If the Amended Offer becomes effective as provided for in the Statement, it will result in the holders of the Debentures receiving a greater realization upon their claims than they would otherwise have received pursuant to the terms of the Initial Proposed Offer as authorized and approved by the Decision.

3. The probability of success in the prosecution of any claims by holders of Debentures to vitiate the enforceability of the contractual subordination provisions of the Debentures and the respective Indentures of Trust relating thereto, is discussed at length in the Decision and incorporated herein as if set forth fully and at length. As reflected by the Decision, it is more likely that the enforceability of such provisions would be upheld than vitiated.

4. No formal objections have been interposed to the Amended Offer other than the ambiguous statement made by Mr. Brewer on behalf of Mr. David Cosoff, alleged holder of 4¾% Debentures in a principal amount of less than \$100,000. As at the date of adjudication, the creditors of the bankrupt estate numbered in the thousands and held claims which exceeded \$1 billion. Mr. Cosoff is but one alleged creditor holding a relatively small portion of the outstanding liabilities. The Bank Claimants whose allowed claims aggregate \$650 million, with approximately 50% remaining unpaid, support the application as do the respective Indenture Trustees, United States Trust Company of New York ("U.S. Trust") for the 4¾% Debentures (principal amount of \$92,507,000) and Citibank, N.A. ("Citibank") for the 4% Debentures (principal amount of

\$834,000). The paramount interest of the creditors of the bankrupt estate and the views expressed by the predominant creditors warrant approval of and authorization for the Amended Offer.

5. The difficulties and complexities of the potential litigation and the expense, inconvenience and delay necessarily attending to it are amply discussed in the Decision and confirmed by the difficulties, complexities, expense and inconvenience which occurred in relation to the Trustee's original application in April of 1979, the Decision and the appeals therefrom which were not resolved until the emergence of the elements of the Amended Offer in April 1981, two years after the commencement of these particular proceedings.

6. The Application be, and the same hereby is, granted and the Amended Offer is authorized and approved.

7. The Trustee be, and he hereby is, authorized to disseminate the Amended Offer to the holders of record of the Debentures as of the date of this order by sending to them a copy of this order, the Decision, the Statement substantially in the form of Exhibit B to the Application and, to the holders of record of the 4¾% Debentures as of said date a Notice of Amended Offer of Settlement and Form of Election and Release substantially in the form of Exhibit C to the Application and, to the record holders of the 4% Debentures as of said record date, the Notice of Amended Offer of Settlement and Form of Election and Release substantially in the form of Exhibit D to the Application.

8. The Trustee be, and he hereby is, directed to place an appropriate notice of the pendency of the Amended Offer in The Wall Street Journal, The New York Times and The Daily News Record on four (4) separate days and in the National Law Journal on two (2) separate days, the first such publication to be no fewer than five (5) nor more than thirty (30) days from the date that the order is entered.

9. Any person or entity involved in the proceedings which were commenced by the Trustee's original application dated April 18, 1979, and in the formulation and effectiveness of the Amended Offer who believes that it is entitled to compensation for the services rendered in relation thereto may file an application for an allowance of compensation and/or reimbursement of documented necessary and proper out-of-pocket expenses, with

the court and serve a copy upon each of Weil, Gotshal & Manges, attorneys for the Trustee, 767 Fifth Avenue, New York, New York 10153, Attention: Harvey R. Miller, Esq.; Davis, Polk & Wardwell, attorneys for Morgan Guaranty Trust Company of New York, as agent, One Chase Manhattan Plaza, New York, New York 10005, Attention: Philip C. Potter, Jr., Esq.; and Whitman & Ransom, attorneys for U.S. Trust, 522 Fifth Avenue, New York, New York 10036, Attention: William M. Kahn, Esq., on or before July 31, 1981, which application shall be heard and considered by the court after notice to the holders of Debentures, on the 11 day of August, 1981, at 2:30 o'clock in the afternoon of that day, or as soon thereafter as counsel can be heard, in Room 234 of the United States Courthouse, Foley Square, New York, New York. Notice of the foregoing hearing shall be set forth in the notice referred to in paragraph 8 of this order and shall be published at least fifteen days prior to the date set forth above for the hearing.

10. The Trustee be, and he hereby is, authorized to take such action as may be necessary and appropriate to implement and effectuate the terms and provisions of the Amended Offer and this order.

Dated: New York, New York  
June 23, 1981

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/s/ JOHN J. GALGAY  
*Bankruptcy Judge*

UNITED STATES DISTRICT COURT  
SOUTHERN DISTRICT OF NEW YORK

In the Matter  
of  
W. T. GRANT COMPANY,  
Bankrupt.

Bankruptcy No.  
75 B 1735

OPINION AND ORDER  
APPROVING OFFER OF COM-  
PROMISE AND SETTLEMENT  
TO HOLDERS OF THE BANK-  
RUPT'S CONVERTIBLE  
SUBORDINATED DEBEN-  
TURES

JOHN J. GALGAY, *Bankruptcy Judge.*

Charles G. Rodman, as Trustee of the Estate of W. T. Grant Company, Bankrupt, filed an application with the Court, dated April 18, 1979, for an order approving and authorizing the dissemination of an offer of compromise and settlement of the claims asserted against the bankrupt estate by the holders of the bankrupt's 4¾% Convertible Subordinated Debentures due 1996 and the 4% Convertible Subordinated Debentures due 1990 (hereinafter respectively referred to as the "4¾% Debentures" and the "4% Debentures" or sometimes collectively as the "Debentures" and the holders as "Subordinated Debentureholders"). By order dated April 18, 1979, the Court set a time and place for a hearing to consider the Trustee's application and directed that notice thereof be given to all parties in interest, the Securities and Exchange Commission and by publication. The hearing commenced on May 22, 1979 and continued, intermittently, on five days thereafter ending on June 19, 1979. Five (5) witnesses testified during the hearing. The transcript of the hearing consists of 987 pages and 80 exhibits were received in evidence aggregating at least 15,000 additional pages. The Trustee and certain claimed Subordinated Debentureholders objecting to the offer of compromise and settlement and its dissemination (the "Objectants"), filed proposed findings of fact and conclusions of law and memoranda of law subsequent to the hearing aggregating in excess of 332 pages.

This proceeding and the Trustee's application in accordance with Section 27 of the Bankruptcy Act, 11 U.S.C. § 50, and Bankruptcy Rule 919(a), represent a further segment in the continuing saga of the administration of this extraordinarily huge and complex bankruptcy case. It is the latest in a series of compromises and settlements spawned by the bankruptcy case and proposed by the Trustee. Each of the compromises, as approved, has enabled the prompt achievement of the objective of bankruptcy cases, i.e., the payment of dividends to claimants entitled thereto. *Grayson-Robinson Stores, Inc. v. Securities and Exchange Commission*, 320 F.2d 940 (2d Cir. 1963).

The major compromises and settlements are described in the decisions approving each of them. *In re W. T. Grant Company*, 3 Bankr.Ct.Dec. 54 (February 14, 1977), *aff'd* (S.D.N.Y. 1977, Knapp, D.J.), *aff'd* 2d Cir. 578 F.2d 1372 (1978) (Secured Suppliers Committee); *In re W. T. Grant Company*, January 18, 1978 (4¾% Sinking Fund Debentures); and *In re W. T. Grant Company*, 4 Bankr.Ct.Dec. 597 (1978) (Bank Claimants).

Before detailing my findings and conclusions, as noted, and pursuant to the directions of the Court made at the conclusion of the hearing, the Trustee and the Objectants to the Trustee's application have each served and filed on all parties in interest their respective proposed findings of fact and conclusions of law. I am aware of the teachings of the United States Supreme Court in *U.S. v. El Paso Natural Gas Co.*, 376 U.S. 651, 656-57; 84 S.Ct. 1044, 1047, 12 L.Ed. 2d 12 (1964), in which trial courts are cautioned not to slavishly follow proposed findings of fact and conclusions of law as submitted by a party. The findings and conclusions as hereinafter set forth are based upon the Trustee's application, the evidence admitted during the hearing and the applicable principles of law. In this opinion, I have adopted findings of fact and conclusions of law submitted by the Trustee for the reason that they accurately state and reflect the true state of the record. It would be a waste of judicial time on my part merely to rephrase proposed findings and conclusions so accurately stated.

In determining to adopt such proposed findings of fact and conclusions of law as part of this opinion, I have scrutinized the Trustee's application, the proposed findings of fact and conclusions of law submitted by the parties and the memoranda of law and other papers submitted by the parties. I have also scrutinized the objections interposed by Messrs. Victor Kurtz and William Kuntz III and I have carefully reviewed the transcript of the hearing. I have found the citations to the record and the references to exhibits admitted into evidence as made on behalf of the Trustee to be accurate.

### **THE BANKRUPTCY CASE**

This proceeding has its genesis in the filing with the Court of a petition for an arrangement under Chapter XI, Section 322 of the Bankruptcy Act, and Bankruptcy Rule 11-6, by W. T. Grant Company ("Grant" or "Bankrupt") on October 2, 1975. By order dated April 13, 1976 Grant was adjudged a bankrupt under the Bankruptcy Act. Charles G. Rodman thereafter qualified as the Trustee of the bankrupt estate and has since acted in that capacity.

### **THE CONTROVERSY**

At the time of the filing of the Chapter XI petition, Grant had recorded liabilities significantly in excess of one billion dollars. A major portion of such liabilities were represented by obligations to banks and to holders of the Subordinated Debentures. During the course of the bankruptcy case claims were filed on behalf of the banks against Grant aggregating \$657,369,048 (the "Bank Claims"). These claims were all incorporated in the proof of claim filed by Morgan Guaranty Trust Company of New York ("Morgan Guaranty") on behalf of itself and as agent for twenty-five (25) bank creditors of Grant (the "Bank Claimants"), Claim No. 525438. By order of this Court dated July 20, 1978 (4 Bankr.Ct.Dec. 597) and in accordance with the Bank Settlement Agreement dated as of February 24, 1978 as authorized and approved by said order, the Bank Claims were allowed in the minimum amount of \$650,000,000. No appeal was filed from the order of July 20, 1978 and the Bank Settlement Agreement has been implemented in accordance with its terms.

The 4% Debentures were issued pursuant to an Indenture dated as of June 1, 1965 (the "1965 Indenture") between Grant and First National City Bank, as Indenture Trustee ("Citibank"). As a result of the exercise of conversion rights, as of the date of bankruptcy the aggregate outstanding principal balance of the 4% Debentures, originally in the amount of \$35,000,000, had been reduced to \$834,000. There are estimated to be 128 holders of the 4% Debentures.

Pursuant to the terms of the 4% Debentures and the 1965 Indenture, the 4% Debentures are subordinated in payment to certain other indebtedness of Grant. The 4% Debentures expressly provide that:

The indebtedness evidenced by the Debentures is, to the extent and in the manner provided in the Indenture, subordinate and subject in right of payment to the prior payment in full of all Senior Indebtedness (as defined in the Indenture) of the Company, whether outstanding at the date of the Indenture or thereafter incurred . . . .

Article Three of the 1965 Indenture sets forth the covenants with respect to the subordination of the 4% Debentures. Section 3.01 of the 1965 Indenture states:

The indebtedness evidenced by the Debentures, including the principal thereof and premium, if any, and interest thereon, shall be subordinate and subject in right of payment, to the extent and in the manner hereinafter set forth, to the prior payment in full of all Senior Indebtedness of the Company, whether now outstanding or hereafter incurred, and each holder of Debentures, by his acceptance thereof, agrees to and shall be bound by the provisions of this Article Three.

The 4¾% Debentures were issued pursuant to an Indenture dated as of April 15, 1971 (the "1971 Indenture") between Grant and The Chase Manhattan Bank, N.A. ("Chase"), as Indenture Trustee. The outstanding principal balance of the 4¾% Debentures originally in the amount of \$100,000,000 had been reduced to \$92,507,000 as of October 2, 1975. As of March 15, 1979, there were 2,315 registered holders of the 4¾% Debentures.

On or about August 14, 1974, Chase resigned as Indenture Trustee and was succeeded by United States Trust Company of New York, as Successor Indenture Trustee for the 4¾% Debentures ("U.S. Trust"). U.S. Trust continues to act as Successor Indenture Trustee under the 1971 Indenture.

Pursuant to the terms of the 4¾% Debentures and the 1971 Indenture, the 4¾% Debentures are subordinated in payment to certain other indebtedness of Grant. The 4¾% Debentures expressly provide that:

The indebtedness evidenced by the Debentures is, to the extent and in the manner provided in the Indenture, subordinate and subject in right of payment to the prior payment in full of the principal of and premium, if any, and interest on all Senior Indebtedness as defined in the Indenture.

Article Four of the 1971 Indenture sets forth the covenants with respect to the subordination of the 4¾% Debentures. Section 4.01 of the 1971 Indenture states:

The indebtedness evidenced by the Debentures, including the principal thereof and premium, if any, and interest thereon, shall be subordinate and subject in right of payment, to the extent and in the manner hereinafter set forth, to the prior payment in full of all Senior Indebtedness of the Company, whether now outstanding or hereafter incurred, and each holder of Debentures, by his acceptance thereof, agrees to and shall be bound by the provisions of this Article Four.

The Bank Settlement Agreement referred to above resolved an adversary proceeding that had been commenced by the Bank Claimants against the Trustee. The Bank Claimants had asserted, *inter alia*, (1) that their claims were secured under a certain Inventory Security Agreement between Grant and Fidelity Union Trust Company, as agent, dated as of May 15, 1975 (the "Inventory Security Agreement"), and a certain Security Agreement between Grant and Morgan Guaranty, as agent, dated as of September 16, 1974 (the "Initial Security Agreement"); and (2) that the aggregate sum of \$90,300,000, net of interest, included as part of the Bank Claims, represented

loans and advances made to Grant as a debtor-in-possession (the "DIP Loans"), which were entitled to priority in payment as costs and expenses of administration of the aborted Chapter XI case in accordance with an order of this Court, dated October 2, 1975, authorizing and approving such loans (the "DIP Order"). In response to the Bank Claimants' assertions, the Trustee had interposed defenses asserting, *inter alia*, that (a) the Bank Claims should be subordinated to the extent deemed appropriate by the Court on the grounds that the Bank Claimants controlled and dominated the business, affairs and conduct of Grant, to the detriment of persons having interests in the business affairs and properties of the Bankrupt; (b) the claimed liens and security interests may have resulted from fraudulent conveyances or preferential transfers voidable under the Bankruptcy Act; and (c) the DIP Loans constituted no more than the release of monies to the debtor-in-possession which were improperly set off against the accounts of the debtor and as such did not give rise to any enforceable claim against assets of the bankrupt estate. The Trustee had also interposed several counterclaims against the Bank Claimants.

In consideration of the allowance of their claims in the minimum amount of \$650,000,000, the Bank Claimants have released as against the bankrupt estate and the Trustee (a) the right to assert claims of liens and security interests together with interest with respect to such claims; (b) claims for interest or other charges in respect of the DIP Loans; and (c) any claim to priority status in respect of the DIP Loans. The Bank Settlement Agreement also provided that the Trustee would retain and reserve a fund in the amount of \$35,000,000 for the partial satisfaction of substantially all allowed claims of general unsecured, unsubordinated creditors of the bankrupt estate ("Participating Creditors"). Based upon the financial condition of the bankrupt estate, the Trustee has estimated that under the Bank Settlement Agreement, Participating Creditors ultimately may receive distributions ranging from 42% to 50% of their allowed claims. The Trustee has estimated that the Bank Claimants ultimately may receive distributions approximating 55% or more of their allowed claims, assuming that the offer of compromise and settlement is authorized and is accepted by at

least 90% of the holders of Grant's 4¾% Debentures and 4% Debentures.

A trustee in bankruptcy is charged with the duty to liquidate the assets of a bankrupt estate and distribute the proceeds thereof to the holders of allowed claims in accordance with the provisions of the Bankruptcy Act and contractual arrangements among such claimants. Accordingly, in absence of a defeasibility as to contractual arrangements, the Trustee would be bound by the subordination provisions of the 4% and 4¾% Debentures and the pertinent Indentures to pay all "Senior Indebtedness" in full before any payment could be made to holders of the Subordinated Debentures. If the Bank Claims are "Senior Indebtedness," the assets of the bankrupt estate are insufficient to pay in full such "Senior Indebtedness." Therefore, until the Bank Claims are paid in full, dividends otherwise distributable to holders of the Subordinated Debentures would be paid to the Bank Claimants in accordance with the aforesaid subordination provisions and Subordinated Debentureholders would receive no return on their claims. However, a controversy has been raised on behalf of holders of 4¾% Debentures as to whether the subordination provisions may be enforced for the benefit of the Bank Claimants. Because of the claimed controversy, the Bank Settlement Agreement provides that the Trustee is not to otherwise distribute the amount of \$95,378,373 (the "Reserve Fund") which represents the full amount of the unpaid outstanding principal and accrued interest of the Subordinated Debentures to October 2, 1975, pending resolution of the controversy either by settlement or by final judgment.

The application seeks approval of and authority to make an offer of compromise and settlement to the Subordinated Debentureholders which, if effective, would allow the Trustee to pay dividends to accepting Subordinated Debentureholders and to the Bank Claimants as contemplated by the compromise and settlement.

In regard to the enforceability of the pertinent subordination provisions the Subordinated Debentureholders and U.S. Trust have made a number of contentions. U.S. Trust has asserted that, from a period commencing in June 1973, to and

including October 2, 1975, when Grant filed its Chapter XI petition, the Bank Claimants may have assumed a position of control, domination and leverage over Grant's management and financial affairs, to the detriment and prejudice of Grant and its other creditors, including the Subordinated Debentureholders. U.S. Trust has alleged that such conduct might mandate that the contractual subordination provisions be vitiated and that the Bank Claimants be equitably subordinated to the claims of the Subordinated Debentureholders. U.S. Trust has alleged that such conduct includes, but is not limited to, the following:

(a) *Initial Security Agreement*: On or about September 16, 1974, Grant's bank lenders compelled Grant to enter into the Initial Security Agreement to secure payment of Grant's unsecured obligations under the Loan and Guaranty Agreement. It is contended that when the Initial Security Agreement was entered into, the Bank Claimants knew or had reasonable cause to believe that Grant was insolvent, and that the granting of security interests would cause Grant's trade suppliers to stop or restrict credit extensions to Grant and thereby substantially reduce the amount of merchandise shipped to Grant stores with concomitant results on revenues and profits. Thereafter, trade suppliers did substantially reduce shipments of merchandise to Grant, resulting in an inadequate supply of inventory for the 1974 Christmas season. As a result of the action taken by the Bank Claimants in compelling Grant to encumber its assets, Grant was irreparably damaged, to the prejudice of Grant's other creditors including the Debentureholders. The disruption of the free flow of goods and services to Grant's stores after the security interest and/or liens were granted to the Bank Claimants impaired the prospects for a successful reorganization of Grant.

(b) *Inventory Security Agreement*: In the early months of 1975, the Bank Claimants, in order to enhance further their position in the event of a proceeding under the Bankruptcy Act, compelled Grant, by means of the Inventory Security Agreement, to give further security interests to the Bank Claimants, *i.e.*, the inventory lien. The Bank Claimants determined, however, that, to obtain such a

security interest without precipitating a case under the Bankruptcy Act, it would be necessary to extend to Grant's trade suppliers an opportunity to obtain collateral security for the payment of future shipments. The Bank Claimants used their position of control and domination of Grant's management to require Grant to offer to its trade suppliers a participation in the Inventory Security Agreement. In promoting the Inventory Security Agreement and the Trade Subordination Agreement, the Bank Claimants caused Grant to contravene the terms of the 1971 Indenture, which provides that the holders of the 4¾% Debentures would be subordinated to certain defined "Senior Indebtedness"—from which definition debt owed in the ordinary course of business to trade and service creditors was excluded.

(c) *Proposed Sale of Accounts Receivable*: In 1974, the Bank Claimants directed Grant not to proceed with a proposed sale of \$100,000,000 of Grant's customer accounts receivable to Beneficial Finance Corporation. A portion of the proceeds from the sale was to be used by Grant to purchase Grant's outstanding 4¾% Debentures in the open market, and to reduce Grant's outstanding loan obligations, the combined effect of which would have had a beneficial effect upon the operating capital requirements of Grant. At the time the Bank Claimants directed Grant not to proceed with the sale of those accounts receivable, the Bank Claimants knew that in any distribution of Grant's assets in a bankruptcy case, by virtue of the subordination provisions contained in the 4¾% Debentures and the 1971 Indenture, no distribution could be made to holders of such Debentures unless and until the claims of the Bank Claimants were satisfied in full. Thus, the Bank Claimants viewed the proposed purchase of such Debentures as detrimental to their own position in the event that a bankruptcy case ensued, not only because of the potential loss of the accounts receivable as security, but also because the Bank Claimants would lose the benefit of the subordination provisions with respect to Debentures which might have been purchased by Grant in the open market.

(d) *Failure to Effect Prompt Reorganization:* The Bank Claimants used their position of control, domination and leverage over Grant's management to prevent Grant from immediately seeking proper relief to enable it to reorganize its operations and debt structure. During the approximate 12 month period commencing October 8, 1974, during which the Bank Claimants purported to perfect security interests and liens in virtually all of Grant's assets, they continued to advance Grant barely sufficient funds to keep Grant from seeking relief under the Bankruptcy Act in order to protect their security interests. Grant continued to operate hundreds of stores which were rendered unprofitable because the Bank Claimants refused to lend sufficient funds for working capital needed, *inter alia*, to purchase adequate merchandise inventory. During such period, Grant's operating losses exceeded two hundred million (\$200,000,000) dollars. The result of the above-described conduct of the Bank Claimants was to weaken Grant internally, to damage its credit with trade suppliers, and to destroy its goodwill with customers. Viable reorganization of the operations and debt structure of Grant was thus effectively precluded, to the detriment of the Debentureholders.

In addition, certain of the Subordinated Debentureholders have filed an adversary proceeding on behalf of all 4¾% Debentureholders asserting further claims. The complaint in the adversary proceeding, entitled *Morris Lewy et al. v. Charles G. Rodman, et al.*, (the "Lewy Action"), asserts as against the Bank Claimants essentially the same averments as the Trustee's answer and counterclaim which were settled by the Bank Settlement Agreement, as well as certain claims against Chase as Predecessor Indenture Trustee for the 4¾% Subordinated Debentureholders. Common law, state and federal claims have also been asserted by or on behalf of Grant security holders, including Subordinated Debentureholders, in the following actions and proceedings: *Weinberger et al. v. Kendrick et al.*, 451 F.Supp. 79 (S. D. N. Y. 1978); *Morris L. Lewy et al. v. Chase Manhattan Bank, N.A., et al.*, Index No. 17837/75, pending in the Supreme Court of the State of New

York, County of New York; *Independent Investor Protective League, Inc., et al. v. Richard W. Mayer et al.*, Index No. 16927/75, pending in the Supreme Court of the State of New York, County of Westchester; and in another adversary proceeding entitled *Independent Investor Protective League, Inc. et al. v. Chase Manhattan Bank, N.A., et al.*

U.S. Trust has also submitted that the 4¾% Subordinated Debentureholders may have actionable claims against Chase in its capacity as the Predecessor Indenture Trustee for the 4¾% Subordinated Debentureholders. In substance, U.S. Trust has contended, *inter alia*, that Chase might have violated the provisions of the Trust Indenture Act of 1939 (the "Trust Indenture Act"), the terms of the 1971 Indenture and its common law fiduciary duty to the 4¾% Subordinated Debentureholders by:

(a) failing to resign as Indenture Trustee after it had acquired a conflicting interest, *i. e.*, a position of control and domination of the business and affairs of Grant, together with the other Bank Claimants;

(b) failing to notify the 4¾% Debentureholders of such conflicting interest;

(c) failing to notify the 4¾% Debentureholders of Grant's filing of allegedly misleading financial reports in 1973 and 1974 which reports failed to disclose a change in accounting treatment of delinquent customer accounts receivable and resulted in an over-statement of earnings in an amount of not less than \$6,000,000;

(d) failing to take action to notify Grant that its filing of allegedly misleading reports could give rise to an Event of Default under the 1971 Indenture, thereby permitting Chase or the 4¾% Debentureholders to accelerate the maturity of the 4¾% Debentures at a time when such Debentures might have been paid in full;

(e) participating in the \$700,000,000 secured Bank loans when Chase knew or had reasonable cause to believe that Grant was insolvent or insolvency was imminent; and

(f) participating, as a bank lender, in directing Grant not to proceed with the proposed sale of \$100,000,000 of

Grant's accounts receivable, a portion of the proceeds of which might have been used to purchase the 4¾% Debentures.

The Bank Claimants maintain that (a) they have valid secured and priority claims against the bankrupt estate as filed and (b) even if their claims were deemed ultimately to be unsecured and not entitled to priority, the subordination provisions contained in the 4% and 4¾% Indentures and Debentures remain valid and enforceable as against the Subordinated Debentureholders. They submit that irrespective of any claimed secured and priority status of the Bank Claims, the Subordinated Debentureholders may not receive any dividends from the bankrupt estate unless and until the claims of the Bank Claimants are satisfied in full.

The Bank Claimants contend as follows:

(a) The Bank Claimants did not owe any fiduciary duty to Grant or its creditors and, even if they did, such duty was in no way breached. They contend that they extended their best efforts to assist Grant in its pursuit of financial rehabilitation, and further, that they relied upon representations allegedly made by the management of Grant that its business was viable and would be profitable, and relied in addition on the financial statements of Grant audited and reported on by Grant's independent accountants. They have asserted that they would not have advanced additional moneys or extended forbearance in 1974 and 1975 if they had believed that the business of Grant was not viable.

(b) There is no precedent for vitiating contractual subordination provisions, such as those contained in the Subordinated Debentures and 4% and 4¾% Indentures, particularly where, as here, said Indentures were entered into in 1965 and 1971, prior to the alleged misconduct of the Bank Claimants. Further, they assert, even if the doctrine of equitable subordination were applicable to the present situation, the relief which might be granted would be limited to the invalidation of the liens and security

interests asserted by the Bank Claimants and would not nullify the subordination provisions of the Debentures.

(c) The Bank Claimants deny that they in any way compelled Grant to enter into the Initial Security Agreement in September of 1974 or that such agreement caused Grant irreparable injury in obtaining merchandise for its business. The Bank Claimants contend that the Initial Security Agreement was freely agreed to by Grant as a prudent and normal security arrangement customary for lending institutions when major loans are extended to a borrower in Grant's position. The Bank Claimants contend that the major credit of \$700,000,000 extended to Grant and partially secured by the Initial Security Agreement was essential to Grant's hopes for profitability and was sought by Grant's management.

(d) The Bank Claimants deny that they compelled Grant to enter into the Inventory Security Agreement in May of 1975 or that such agreement in any way violated the terms of the 1971 Indenture or of the 4¾% Debentures. Moreover, the ability of Grant to grant security interests to its suppliers was not precluded by any negative pledge clause contained either in the 1971 Indenture or the 4¾% Debentures, and Grant was entitled to grant such security interests at any time provided only that Grant's senior debentures were equally and ratably secured.

(e) The Bank Claimants deny that they directed Grant not to proceed with a proposed sale of \$100,000,000 of customer accounts receivable. The Bank Claimants contend that the proposal was rejected by Grant's management.

(f) The Bank Claimants deny that they exercised a position of control or domination over Grant or prevented Grant from seeking rehabilitation under the Bankruptcy Act. The Bank Claimants contend that they consistently acted as responsible lending institutions.

Chase has denied all of the U.S. Trust's allegations described above and has asserted the following:

(a) It never assumed control or domination of Grant, either individually or in concert with any of the other Bank Claimants;

(b) It resigned its position as Indenture Trustee in August, 1974;

(c) While serving as Indenture Trustee, it was never in a position of conflict of interest with the 4¾% Debentureholders;

(d) No event of default became known to it during the period of its indenture trusteeship which would have permitted acceleration of the Subordinated Debentures;

(e) During the time it acted as Indenture Trustee and at all relevant times after its resignation in August of 1974, it had no knowledge or reason to know of any alleged material misstatements in Grant's 1973 and 1974 financial statements and the accompanying reports of Grant's independent accountants and it relied on such statements and reports as being accurate in making substantial loans to Grant prior to October 1974 and in entering into the \$700,000,000 secured loans to Grant in October of 1974; and

(f) Grant's contemplated sale in the summer of 1974 of some \$100,000,000 of its accounts receivable on a discounted basis was terminated because of opposition to the sale within Grant's management as a transaction which was not in the best interests of Grant.

U.S. Trust has also asserted that the 4¾% Debentures constitute "Senior Indebtedness" as that term is defined in the 1965 Indenture. Accordingly, U.S. Trust maintains that any payments which may be made to holders of the 4% Debentures or the Indenture Trustee therefore must be paid over to the holders of the 4¾% Debentures. U.S. Trust notes that the term "Senior Indebtedness" is defined in the 1965 Indenture as "the principal of and premium, if any, and interest on . . . (b) indebtedness of [Grant] evidenced by notes or debentures (other

than the [4%] debentures) issued under the provisions of an Indenture or similar instrument between [Grant] and a bank or trust company . . . unless, in each case by the terms of the instrument by which [Grant] incurred, assumed or guaranteed such indebtedness, it is expressly provided that such indebtedness is not superior in right of payment to the [4%] Debentures." U.S. Trust maintains that the 1971 Indenture does not specifically state that the 4¾% Debentures are *not* superior in right of payment to the 4% Debentures and, therefore, that the 4¾% Debentures are superior to the 4% Debentures.

Citibank, as Indenture Trustee for the 4% Debentures, maintains that the definition of Senior Indebtedness contained in the 1971 Indenture indicates that the Debentures are *pari passu* since both are coupled as not being within the definition of Senior Indebtedness. As the relative priority of the 4¾% Debentures and the 4% Debentures is not entirely clear and, in view of the *de minimis* principal amount of the 4% Debentures presently outstanding (\$834,000), the Trustee has proposed that the offer of compromise be made to holders of 4% Debentures as well as holders of 4¾% Debentures and has required, as a condition of the offer, that the holders of the 4¾% Debentures who elect to accept the offer release any claims that they may have against the holders of the 4% Debentures and Citibank, as Indenture Trustee, for distributions made to such holders from the bankrupt estate.

## THE OFFER OF COMPROMISE AND SETTLEMENT

The full prosecution and determination of the dispute between the Trustee, U.S. Trust, the 4¾% Debentureholders and the Bank Claimants, including Chase, could be unduly protracted, resulting in great expense and a substantial delay in the administration of the bankrupt estate. As a consequence, the Trustee, the Bank Claimants and U.S. Trust explored the possibility of a compromise and settlement. The discussions that ensued extended over a period of many months. As a result of these discussions, the framework of the proposed offer of compromise and settlement evolved (the "Offer"). The terms of the Offer are set forth in full in the Trustee's application and were modified during the hearing and further by agreement of the

Trustee, the Bank Claimants and the Indenture Trustees as embodied in a letter addressed to the Court dated January 23, 1980.

(a) *The Payment Terms*

Pursuant to the Offer each holder of Subordinated Debentures may elect to receive a payment in full satisfaction of the obligations of Grant and its successors based upon such holder's Subordinated Debentures. Each Subordinated Debentureholder will be offered the opportunity to elect to receive, subject to the terms and conditions of the Offer, a net amount in cash equal to fourteen percent (14%) of the unpaid principal amount of each Subordinated Debenture properly tendered by a Subordinated Debentureholder pursuant to the Offer, as amended. The accepting Subordinated Debentureholder will have no responsibility for the fees and expenses of its Indenture Trustee. Prior to the amendment of January 23, 1980 the Offer spoke in terms of a gross amount equal to fifteen percent (15%) but subject to deduction from that amount of the allocable fees and expenses of the particular Indenture Trustee. The implementation of those provisions would have had the effect of limiting the net recovery of an accepting Subordinated Debentureholder to a minimum of thirteen percent (13%) and a maximum of 13.85%, dependent upon the percent of accepting Subordinated Debentureholders. The modification assures accepting Subordinated Debentureholders of receiving a dividend equal to fourteen percent (14%) of the principal of properly tendered Subordinated Debentures. The payment of the fees and expenses of U.S. Trust in an amount not to exceed \$975,000 and the fees and expenses of Citibank in an amount not to exceed the lesser of two percent (2%) of the unpaid principal amount of the 4% Debentures properly tendered or \$16,000 will be made from the Reserve Fund to the extent not used to pay or be reserved for the claims of Subordinated Debentureholders.

Upon the Trustee's payment to an accepting Subordinated Debentureholder, such holder shall have no further rights in respect of the tendered Debentures, or under the respective Indentures, or in respect of the purchase or sale of or investment in the Debentures as against (a) the Trustee; (b) the bankrupt

estate; (c) the Bank Claimants; (d) the 116 banks whose loans to Grant or W.T. Grant Financial Corporation ("Grant Financial") were paid in June of 1975; (e) in the case of the 4¾% Debentures, Chase, as Predecessor Indenture Trustee, U.S. Trust, as Successor Indenture Trustee, the holders of the 4% Debentures and Citibank, as Indenture Trustee therefor; and (f) in the case of the 4% Debentures, Citibank, as Indenture Trustee. Each Subordinated Debentureholder and each Indenture Trustee shall retain (x) all rights and remedies with respect to any claim relating to the respective Subordinated Debenture or Indentures against any persons other than those listed above and (y) all rights and remedies to obtain payment from the Trustee and the bankrupt estate of any indebtedness owed other than under the Subordinated Debentures, the respective Indentures, or in respect of the purchase or sale of or investment in the said Debentures.

Upon the Trustee's payment to U.S. Trust and Citibank each of which, for purposes of administering the payments due to accepting Subordinated Debentureholders, will be appointed as a Paying Agent without compensation, U.S. Trust and Citibank shall have no obligation or duty to enforce the rights of any accepting Subordinated Debentureholder of the 4¾% Debentures or 4% Debentures, respectively. As to nontendering Subordinated Debentureholders, all rights under the Subordinated Debentures to obtain payment in full of their claims are preserved.

Neither the Offer nor the Bank Settlement Agreement or any proceedings relating to either is to constitute a determination, in any subsequent action or proceeding of any kind, concerning (a) the rights, claims and defenses of the non-accepting Subordinated Debentureholders or their representatives or of their respective Indenture Trustees; (b) the validity or enforceability of the liens, security interests or priority claims asserted by the Bank Claimants (including claims to interest and to the enforcement of any rights as third party beneficiaries under any subordination agreements except with respect to accepting Subordinated Debentureholders and the Indenture Trustees in respect thereof) or any defenses of the Bank Claimants; and (c) all such rights, defenses and claims as the non-

accepting Subordinated Debentureholders or their representatives or the Bank Claimants or Chase may have. Such rights, defenses and claims are expressly preserved without prejudice in any subsequent action or proceeding concerning the rights of such non-accepting Subordinated Debentureholders.

Acceptance of the Offer by all Subordinated Debentureholders would result in the payment to such holders of an aggregate amount of about \$13,206,000 net of the approximately \$1,000,000 to reimburse the fees and expenses of the Indenture Trustees.

(b) *Transmittal and Acceptance of the Offer.*

The Trustee is to disseminate the Offer by distributing to the Subordinated Debentureholders a "Notice of Offer and Form of Election and Release", on which each Subordinated Debentureholder may indicate his acceptance of the Offer, and such other documents as hereinafter directed, including a conformed copy of the order approving the compromise and settlement and authorizing dissemination of the Offer and the Trustee's application, as amended in accordance with the modifications made during the hearing and thereafter. These documents, along with a letter from the respective Indenture Trustees regarding the Offer will be mailed, at the Trustee's expense, by the respective Indenture Trustees to each holder of record of the Subordinated Debentures. The Trustee will also place a notice of pendency of the Offer in The Wall Street Journal (National Edition), The New York Times and the Daily News Record on four (4) separate days in accordance with the terms of the Offer.

To tender Subordinated Debentures for payment pursuant to the Offer, a Subordinated Debentureholder must send or deliver to the Trustee the following:

(a) a properly executed Form of Election and Release;  
and

(b) the Debentures as to which the Offer is being accepted in proper form for transfer or, in the event any such Debentures have been stolen, lost or destroyed, a properly executed affidavit of loss and such indemnity bond

or agreement as the Trustee, the respective Indenture Trustees and Chase, as Debenture Registrar, shall specify.

Other pertinent provisions of the Offer as to the Form of Election and Release, the Expiration Date of the Offer, and the Paying Agents are set forth in the Trustee's application, as amended.

*(c) Requirements for Offer to Become Effective*

The Trustee's acceptance of all tenders of 4¾% Debentures pursuant to the Offer shall become effective when U.S. Trust has delivered to the Trustee a certificate reflecting that 4¾% Debentures with an unpaid principal amount of not less than \$83,257,000 (equal to approximately 90% of the aggregate principal amount of the 4¾% Debentures outstanding), or, if elected by the Bank Claimants, such reduced amount as provided in the Offer, have been validly tendered. The Trustee, at any time prior to the Expiration Date, solely upon receipt of a written request of Morgan Guaranty that the unpaid principal amount of 4¾% Debentures which the Trustee may accept be reduced to an amount less than \$83,257,000, shall file promptly with this Court and deliver to U.S. Trust a writing stating such reduced amount and shall publish in the national edition of The Wall Street Journal a notice to the 4¾% Subordinated Debentureholders stating the reduced amount, and upon such filing such reduction shall become effective without further notice. If the certificate delivered by U.S. Trust, as Successor Indenture Trustee, reflects that the unpaid principal amount of the 4¾% Debentures validly tendered is less than \$83,257,000, or less than such reduced amount as shall have been elected by the Bank Claimants, the Trustee will return all tendered 4¾% Debentures and all forms of Election and Release to the Subordinated Debentureholders.

The Trustee's acceptance of all tenders of 4% Debentures pursuant to the Offer shall become effective when both of the following events have occurred: (a) the Trustee's acceptance of the tender of 4¾% Debentures has become effective and (b) Citibank has delivered to the Trustee a certificate reflecting that 4% Debentures with an unpaid principal amount of not less than \$750,600 (equal to 90% of the aggregate principal amount of the

4% Debentures outstanding), or, if elected by the Bank Claimants, such reduced amount as provided in the Offer, have been validly tendered. The Trustee, at any time prior to the Expiration Date, solely upon receipt of a written request of Morgan Guaranty that the unpaid principal amount of 4% Debentures which the Trustee may accept be reduced to an amount less than \$750,600, shall file promptly with this Court and deliver to Citibank a writing stating such reduced amount and shall publish in the national edition of *The Wall Street Journal* a notice to the 4% Subordinated Debentureholders stating the reduced amount, and upon such filing such reduction shall become effective without further notice. If the certificate delivered by Citibank shows that the unpaid principal amount of the 4% Debentures validly tendered is less than \$750,600, or less than such reduced amount as shall have been elected by the Bank Claimants, the Trustee will return all tendered 4% Debentures and all Forms of Election and Release to the Subordinated Debentureholders.

As to any Subordinated Debentures tendered during the first ninety (90) days after the order approving the Offer has become final, as defined, or during any extensions thereof up to and not more than a total of an additional sixty (60) days (such period of time and all such extensions referred to as the "Initial Period"), the Expiration Date of the Offer shall be deemed to be the last day of the Initial Period. If the principal amount of Subordinated Debentures required for effectiveness of the Offer is not obtained, on or before the last day of the Initial Period, the Bank Claimants shall either (a) reduce the principal amount of tendered Subordinated Debentures required for effectiveness of the Offer to the principal amount of the Subordinated Debentures tendered during the Initial Period with the result that the Offer shall then become effective as to such Subordinated Debentures, or (b) indicate, in the manner set forth in the application, that they are not reducing the requisite principal amount of such Subordinated Debentures so as to permit the Offer to become effective, in which event the Offer shall be deemed withdrawn as to any and all Subordinated Debentures and any tendered Subordinated Debentures will be returned to the persons who tendered said Debentures.

If the Offer has become effective as to the Subordinated Debentures tendered during the Initial Period, then, as to such Debentures not tendered during the Initial Period, at the option of the Bank Claimants, the Expiration Date may be extended for one or more periods not to exceed in the aggregate three (3) years from the date the order become final. In the event of such further extensions, closings, as provided in the application, shall be held every three (3) months; provided, however, that closings shall not be required unless Subordinated Debentures aggregating at least \$100,000 in principal amount are tendered during such three (3) month period.

*(d) Distribution of Balance of Reserve Fund.*

Section 3.3 of the Bank Settlement Agreement provides that upon resolution of the right of Subordinated Debentureholders to receive distributions from the assets of the bankrupt estate before payment in full of the Bank Claims, the balance of the moneys retained by the Trustee pursuant to Sections 3.1 and 3.2 thereof and not distributed to Subordinated Debentureholders shall be distributed to the Bank Claimants in accordance with the Bank Settlement Agreement. Consequently, concurrently with payment (a) to the respective Paying Agents of the amounts required for accepting Subordinated Debentureholders and (b) of the amounts payable to U.S. Trust and Citibank with respect to their fees and expenses, the Trustee will pay to Morgan Guaranty, as agent for the Bank Claimants, an amount equal to the unpaid principal and interest accrued to October 2, 1975 in relation to the tendered and accepted Subordinated Debentures less (x) the amounts paid to the Paying Agents and to U.S. Trust and Citibank as to their fees and expenses, and (y) the deposits that may be made pursuant to the terms of the Offer as to disputed amounts. The balance of the moneys retained by the Trustee subject to the restriction against distribution under the Bank Settlement Agreement (which amount shall be the amount of the unpaid principal and accrued interest to October 2, 1975 on all Subordinated Debentures not tendered and accepted) will be subject to such restriction until the resolution by settlement pursuant to court order or by final judgment of the right, if any, of such non-accepting

Subordinated Debentureholders to receive any distributions from the assets of the bankrupt estate because of the subordination provisions contained in the Subordinated Debentures and the respective Indentures pertaining thereto.

## THE OBJECTIONS

### (a) *The Objectants.*

The principal objections to the Trustee's application and the Offer were filed on behalf of eleven (11) claimed holders of 4¼% and 4% Debentures.

Mr. Victor Kurtz, the principal objectant, claims to be chairman of an Ad Hoc Protective Committee of Holders of 4¼% Debentures. Mr. Kurtz claims to own \$870,000 in principal amount of 4¼% Debentures. The eleven (11) objectants, inclusive of Mr. Kurtz (hereinafter collectively referred to as "Kurtz Objectants"), claim to hold a total of \$2,001,000 in 4¼% Debentures, or approximately 2% of the total amount outstanding, and \$75,000 in 4% Debentures, or approximately 8% of the total amount outstanding.

Mr. Kurtz began purchasing 4¼% Debentures in January, 1976, several months after Grant filed its Chapter XI petition. He and his attorney, I. Walton Bader, have been active in the case since that date. Mr. Kurtz has continually and actively engaged in the purchase and sale of 4¼% Debentures since January, 1976 and has entered into a profit sharing agreement with another individual relating to the post-bankruptcy purchase and sale of 4¼% Debentures. Mr. Kurtz testified that the average cost of his holdings approximates \$60 per \$1,000 of face amount of 4¼% Debentures, considerably less than the amount which he would recover if he accepted the Offer.

The evidence does not support that Mr. Kurtz or his attorneys were authorized by all of the other named objectants, which they purport to represent, to file any objections to the Trustee's application or to make the assertions set forth in the objections signed by Mr. Kurtz. The testimony given by Messrs. Kurtz and Bader at the hearing demonstrates that there were no

communications with such other persons as to the specific objections made or that the Committee has ever held a meeting or functioned as a true committee.

Objections to the Offer were also filed by Mr. Kuntz as the claimed holder of \$90,000 in principal amount of 4 $\frac{3}{4}$ % Debentures. Mr. Kuntz rejects the economic terms of the Offer and contends that it is founded upon inappropriate data. He claims that the Offer is based solely on the public market price of 4 $\frac{3}{4}$ % Debentures at various times preceding the filing of the Bankrupt's Chapter XI petition and as such it fails to consider prices paid for similar types of debentures during the same period. Mr. Kuntz did not introduce any evidence or submit any authority in support of his contentions. He has not demonstrated any basis upon which to justify denial of the Trustee's application. Accordingly, I find that his objection is not worthy of any further consideration.

Additionally, a group of institutional investors\* (hereinafter "Institutional Holders") submitted a memorandum setting forth their position as to the Offer. In substance, the Institutional Holders do not object to the Trustee's application or urge denial of said application. Rather, they claim that the Offer contains certain inequitable features which may mandate their rejection of the Offer. Those features relate to the contemplated releases in favor of Chase and U.S. Trust as set forth above. The Institutional Holders submit that the releases are unnecessary and gratuitous. Further, the Institutional Holders urge that the fees and expenses of U.S. Trust should be borne by all of the 4 $\frac{3}{4}$ % Subordinated Debentureholders. The latter point has been resolved by the modification of the Offer hereinabove described. The Institutional Holders also claim that the Subordinated Debentureholders should receive interest in respect of the moneys that the Trustee agreed not to distribute under the terms of the Bank Settlement Agreement.

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\*This group consists of: State of Michigan Employees Pension Trust; State of Illinois Teachers Pension Trust; American United Life Insurance Co.; Title Insurance & Trust Co., Los Angeles; County Life Insurance Co., Bloomington, Illinois; Howe Barnes & Johnson, Inc.

I find no substance in the criticism and comments submitted by the Institutional Holders. The Offer is a result of arm's length negotiations among the Trustee, the Bank Claimants, Chase and U.S. Trust. For the reasons hereinafter stated, it represents a fair and equitable solution to the controversy as to who is entitled to receive dividends from the bankrupt estate. It is consistent with the Congressional policy favoring the compromise and settlement of controversies relating to a bankrupt estate. There has been no evidence of any kind introduced in this proceeding or otherwise which would tend to indicate that either Chase or U.S. Trust committed any act in their respective capacities as Indenture Trustee and Successor Indenture Trustee for the 4¾% Debentures which would give rise to any liability to Subordinated Debentureholders. Finally, the Bank Settlement Agreement only provided a mechanism to assure that the Trustee retained sufficient funds in the bankrupt estate pending the disposition of the controversy. It did not provide for the creation of an escrow or segregated fund for the benefit of any party. The Bank Settlement Agreement does not contain any provision requiring the segregation of funds or the investment thereof for the benefit of Subordinated Debentureholders.

The Subordinated Debentureholders are general unsecured creditors of the bankrupt estate. It is a long established principle of bankruptcy jurisprudence that interest is not payable to general unsecured creditors of an insolvent bankrupt estate. It is indisputable that Grant was insolvent at the time of the commencement of the bankruptcy case and that general unsecured creditors will not receive 100% of their claims. Therefore, the Subordinated Debentureholders are not entitled to interest on their claims. *Sexton v. Dreyfus*, 219 U.S. 339 31 S.Ct. 256, 55 L.Ed. 244 (1911).

(b) *The Objections As Asserted By Mr. Kurtz.*

The Kurtz Objectants essentially assert three (3) bases upon which they urge the denial of the Trustee's application, i.e., (1) the Trustee has failed to make an adequate presentation of the facts and law relating to the controversy to support the approval of the Offer and its dissemination; (2) the Bank Claims should be equitably subordinated because of the control and

dominion of Grant allegedly exercised by the Bank Claimants; and (3) the Trustee, U.S. Trust and their respective counsel are subject to alleged conflicts of interest which require each of them to be disqualified.

### **THE COMPROMISE AND SETTLEMENT IS IN THE BEST INTEREST OF THE BANKRUPT ESTATE AND THE DEBENTUREHOLDERS**

It is clear to this Court, after a review of the record, the exhibits, memoranda, other papers and all of the proceedings had before it, that the Trustee had apprised himself of "all facts necessary for an intelligent and objective opinion of the probabilities of ultimate success should the [controversy] be litigated." *Protective Committee for Independent Stockholders of TMT Trailer Ferry, Inc. v. Anderson*, 390 U.S. 414, 88 S.Ct. 1157, 20 L.Ed.2d 1 (1968). It is also evident that the Trustee formed "an educated estimate of the complexity, expense, and likely duration of such litigation, \* \* \* and all other factors relevant to a full and fair assessment of the wisdom of the proposed compromise." *Ibid* at 424, 88 S.Ct. at 1163. Also, it is obvious that the Trustee compared "the terms of the compromise with the likely rewards [or lack thereof] of litigation," *Ibid* p. 425, 88 S.Ct. p. 1163, for the Subordinated Debentureholders. Thus, the Trustee has discharged his statutory responsibilities. *In re Blair*, 538 F.2d 849 (9th Cir. 1976).

The authority of a trustee to compromise and settle controversies relating to the administration of a bankrupt estate is proscribed only by the requirement that the compromise be " \* \* \* with the approval of the court." Section 27 of the Bankruptcy Act, 11 U.S.C. §50; Bankruptcy Rule 919(a). The Trustee has recommended that the Offer be approved and authorized as being in the best interest of the bankrupt estate and its creditors, particularly the Subordinated Debentureholders. In considering the Trustee's recommendation, this Court must weigh certain factors to determine whether the Offer is in the best interest of the bankrupt estate. These factors were aptly stated in *Drexel v. Loomis*, 35 F.2d 800 (8th Cir. 1929):

In determining the advisability of accepting an offer of compromise, many considerations are addressed to the

sound discretion of the referee. . . . Among them: (a) The probability of success in the litigation; (b) the difficulties, if any, to be encountered in the matter of collection; (c) the complexity of the litigation involved, and the expense, inconvenience and delay necessarily attending it; (d) the paramount interest of the creditors and a proper deference to their reasonable views in the premises.

*Id.* at 806. *Accord*, *Protective Committee for Independent Stockholders of TMT Trailer Ferry, Inc. v. Anderson*, 390 U.S. 414, 88 S.Ct. 1157, 20 L.Ed2d 1 (1968).

Consideration of each of the factors described in the *Drexel* case, *supra*, irresistibly leads to the conclusion that the Offer should be approved and authorized and disseminated to Subordinated Debentureholders.

(a) "*The probability of success in the litigation*".

The Trustee has directed an investigation into the acts, conduct, property and affairs of Grant. That investigation has encompassed the Bank Claimants' relationship with Grant and the status of the Bank Claims. The investigation has been conducted primarily through the use of oral examinations under Bankruptcy Rule 205(a) and the examination, analysis and review of the books, records, papers and documents of Grant, its officers, directors and employees as well as documents, papers, records and other materials produced by the Bank Claimants and others in response to the Trustee's requests. Over 9,000 pages of stenographic transcript have resulted from such examinations. Hundreds of thousands of documents have been examined, reviewed and analyzed on behalf of the Trustee. The relationship of the Bank Claimants to Grant was carefully considered in connection with the approval of the compromise and settlement of the adversary proceeding commenced by the Bank Claimants against the Trustee over the objections of Mr. Kurtz. *In re W.T. Grant Company*, 4 Bankr.Ct.Dec. 597 (1978).

The hearing before the Court demonstrates that the Trustee carefully weighed the probabilities of a successful prosecution of contentions to invalidate the contractual subordination provisions relating to the 4% and 4¾% Debentures. It is hornbook

law that consensual or contractual subordination agreements of the type contained in the 1965 and 1971 Indentures and the 4% and 4¾% Debentures are enforceable in bankruptcy. *In re Credit Industrial Corp.*, 366 F.2d 402 (2d Cir. 1966).

The legend "SUBORDINATED" is clearly imprinted on each of the debenture certificates as part of the title of the security. The terms of the 4% and 4¾% Debentures and the respective Indentures specifically provide that the debt represented by such Debentures is subordinated and that the holder thereof agrees to the subordination of the debt to the payment of Senior Indebtedness. In a similar context, the United States Court of Appeals for the Second Circuit in *In re Credit Industrial Corp.*, *supra*, reasoned:

Creditors who expressly agree to subordinate their claims against a debtor and the creditors for whose benefit the agreement to subordinate is executed are not similarly situated.

\* \* \*

[C]onsensual or contractual subordination, of which the debt subordination agreements involved here are prime examples, occurs when a creditor and the bankrupt agree to create priorities among debts. Such agreements have been uniformly enforced according to their terms by bankruptcy courts.

\* \* \*

*A bankruptcy court, in order to effectuate its duty to do equity, must enforce lawful subordination agreements according to their terms and prevent junior creditors from receiving funds where they have "explicitly agreed not to accept them."*

366 F.2d at 408-10 (Emphasis added) (citations omitted). See also *In re Associated Gas & Electric*, 149 F.2d 996 (2d Cir.), cert. denied 326 U.S. 736, 66 S.Ct. 45, 90 L.Ed 439 (1945); *In re Aktiebolaget Kreuger & Toll*, 96 F.2d 768 (2d Cir. 1938); American Bar Foundation Corporate Debt Financing-Project, *Commentaries on Model Debenture Indenture Provisions*, 579, 581 (1971).

Senior Indebtedness is defined in Section 1.01 of the 1971 Indenture to include "indebtedness \* \* \* of [Grant] for money borrowed from or guaranteed to persons, firms or corporations evidenced by notes or similar obligations." Review of the relevant documents indicates that it is most probable that in any litigation it would be determined that the loans made by the Bank Claimants constitute Senior Indebtedness prior to and after the execution of the Interim Loan and Guarantee Agreement.

The Kurtz Objectants contend that future borrowings are not included in the term Senior Indebtedness. It is contended that the definition of Senior Indebtedness in the 1971 Indenture when read "with due regard to \* \* \* punctuation" is ambiguous. I disagree. The record of the hearing demonstrates that the term "Senior Indebtedness" as defined in the 1971 Indenture contemplates future borrowings of the type described in Article One, Section 1.01(a) of the Indenture. Standard English usage and the reading of the pertinent provisions of the 1971 Indenture and the 4¼% Debentures makes such conclusion inescapable.

In Section 1.01 of the 1971 Indenture, it is clearly stated:

The term "Senior Indebtedness" shall mean the principal of and premium, if any, and interest on (a) indebtedness \* \* \* of [Grant] for money borrowed from or guaranteed to persons, firms or corporations evidenced by notes or similar obligations, (b) indebtedness of [Grant] evidenced by notes or debentures (other than [the 4% and 4¼% Debentures]) issued under the provisions of an indenture or similar instrument between [Grant] and a bank or trust company or (c) purchase money indebtedness of [Grant], *in each case, whether outstanding at the date of execution of this indenture or thereafter incurred* \* \* \*

(Emphasis added).

The clear import of Section 1.01 is that Senior Indebtedness includes indebtedness specified in clauses (a), (b) and (c) irrespective of whether outstanding at the date of the 1971 Indenture or thereafter incurred. Manifestly "in each case" relates back to and modifies each of the types of indebtedness described in clauses (a), (b) and (c) of Section 1.01.

The Kurtz Objectants urge that the use of a comma rather than a semicolon as the punctuation preceding the emphasized language requires that such language only modify and relate to the type of indebtedness described in clause (c), i.e., "purchase money indebtedness of [Grant]". However, reference to Article Four of the 1971 Indenture, which specifically states that the 4¾% Debentures are subordinate to "all Senior Indebtedness \* \* \* whether now outstanding or hereinafter incurred \* \* \*" undercuts the contention of the Kurtz Objectants. Article Four contains the operative provisions of the 1971 Indenture as to subordination. Furthermore, even if an inconsistency between the provisions of the Sections of Articles One and Four could be contrived, the construction to be adopted should be that which will harmonize the provisions. *National Conversion Corp. v. Cedar Building Corp.*, 23 N.Y.2d 621, 625, 298 N.Y.S.2d 499, 246 N.E.2d 351 (1969).

The Kurtz Objectants' reliance on the punctuation of the 1971 Indenture is misplaced. It has long been settled that punctuation alone does not control the meaning of an indenture. It is the least reliable standard for the interpretation of a writing. As stated by the United States Supreme Court:

Punctuation is a most fallible standard by which to interpret a writing; it may be resorted to when all other means fail, but the court will first take the instrument by its four corners, in order to ascertain its true meaning; if that is apparent on judicially inspecting the whole, the punctuation will not be suffered to change it.

*Ewing's Lessee v. Burnet*, 36 U.S. (11 Pet.) 41, 54, 9 L.Ed 624 (1837). See also *Clayman v. Goodman Properties, Inc.*, 171 U.S. App.D.C. 88, 93 n. 24, 518 F.2d 1026, 1031 n.24 (D.C.Cir.1973); *Holmes v. Phenix Ins. Co.*, 98 F. 240, 241, 242 (8th Cir. 1899) ("The Century Dictionary tells us, what is common knowledge, that 'there is still much uncertainty and arbitrariness in punctuation.' It is always subordinate to the text, and is never allowed to control its meaning."). This rule of construction was adopted by the New York Court of Appeals in *Wirth & Hamid Fair Booking, Inc. v. Wirth*, 265 N.Y. 214, 219, 192 N.E. 297 (1934).

The Kurtz Objectants argue that the Trustee has failed to make an impartial presentation of their contention. I am satisfied that the Trustee has made an impartial presentation for the consideration of the affected parties. The Trustee's application states, at length and without comment, the pertinent provisions of the 1971 Indenture and the 4 $\frac{3}{4}$ % Debentures with respect to the inclusion of future borrowings within the definition of Senior Indebtedness. Moreover, at the hearing the controlling provisions of Articles One and Four of the 1971 Indenture were read into the record on behalf of the Trustee.

The Kurtz Objectants contend that the Trustee "should have called to [the Subordinated Debentureholders] attention those cases which have held that ambiguous language should be interpreted against those which were responsible for its use." The cases referred to by the Kurtz Objectants are inapposite. The definition of Senior Indebtedness as stated is not ambiguous. Further, the "terms of the debentures must therefore be \* \* \* 'fairly construed in the light of the \* \* \* circumstances,' no matter who was responsible for drafting them." *Zeiler v. Work Wear Corp.*, 450 F.Supp. 891, 894 (S.D.N.Y. 1978), quoting, *Buchman v. American Foam Rubber Corp.*, 250 F.Supp. 60, 75 (S.D.N.Y. 1965). Finally, the only testimony at the hearing in relation to the foregoing is to the effect that the Bank Claimants were not involved in the drafting of the 1971 Indenture.

It is also asserted by the Kurtz Objectants that the Bank Claims do not constitute Senior Indebtedness under the terms of the 1971 Indenture, Section 1.01, *supra*, because the Bank Claimants did not obtain direct claims against Grant until August of 1974. Prior to that time loans and advances were made to Grant Financial. In August of 1974 and in accordance with the Interim Loan and Guaranty Agreement, Grant guaranteed the payment of the indebtedness due to the lending banks from its wholly owned subsidiary, Grant Financial.

The Bank Claimants submit that by virtue of the guaranty the Bank Claims constitute Senior Indebtedness in accordance with the provisions of the 1971 Indenture. The Kurtz Objectants contend that the guaranty must be invalidated by reason of the alleged dominion and control of Grant's affairs by

the Bank Claimants. This argument relates to the application of the doctrine of equitable subordination which this Court had earlier occasion to review in connection with this case in approving and authorizing the Bank Settlement Agreement. *In re W. T. Grant Company*, 4 Bankr. Ct. Dec. 597 (1978). I concluded that the probabilities of success in asserting such a claim were negligible. The Kurtz Objectants have not presented any new evidence or even information which would tend to compel a different conclusion. A further discussion of the doctrine of equitable subordination will be found in later portions of this Opinion.

In relation to the Bank Claims and Grant and its wholly owned subsidiary, Grant Financial, I am in agreement with the Trustee that Grant Financial would constitute a senior creditor of Grant and that the Bank Claims, as direct creditors of Grant Financial, would benefit from such senior creditor status even if the guaranty were vitiated. Grant Financial was organized for the sole purpose of making loans to Grant and borrowing funds for that purpose. This relationship is evidenced by an agreement dated as of April 29, 1970, pursuant to which Grant Financial agreed to lend to Grant for its "general business purposes, sums against the issuance and delivery to [Grant Financial] of [Grant's] promissory note, payable on demand \* \* \*." The record establishes that Grant's indebtedness to Grant Financial was evidenced by Grant's promissory notes which were payable on demand. At the time of the filing of the Chapter XI petition the indebtedness of Grant to Grant Financial was evidenced by an Intercompany Demand Note dated August 6, 1975 in the amount of \$819,887,663. A proof of claim filed against the bankrupt on behalf of Financial asserts a claim in the amount of \$819,887,663. Claim No. 525386.

As provided in Section 1.01(a) of the 1971 Indenture, the indebtedness of Grant to Grant Financial evidenced by notes constitutes Senior Indebtedness. Further, the ledger of Grant Financial reflects in detail the loans made by that entity to Grant and the amounts owing to it as reflected in notes receivable. The Bank Claimants would be the beneficiaries of the Senior Indebtedness status of the claims of Grant Financial.

Clearly, if the corporate identities of Grant and Grant Financial are to be respected it is obvious that the indebtedness of Grant to Grant Financial is entitled to the benefits of the subordination provisions of the 1971 Indenture and the 4¾% Debentures. There is no exclusion in the definition of Senior Indebtedness for intercompany indebtedness. Moreover, even if the separate corporate identities were to be disregarded on the basis that Grant Financial was an alter ego, agent or instrumentality of Grant, such a determination would not inure to the benefit of Subordinated Debentureholders.

A substantive consolidation of parent and subsidiary corporation results in the liabilities of the parent and subsidiary being consolidated and constituting direct liabilities of the consolidated entity. *Chemical Bank New York Trust Co. v. Kheel*, 369 F.2d 845 (2d Cir. 1966). If a substantive consolidation of Grant and Grant Financial were to occur then Grant would be a direct obligor to the Bank Claimants for all moneys borrowed by its consolidated subsidiary, Grant Financial. Inasmuch as such borrowings are represented by notes, there would be no question that borrowings would constitute Senior Indebtedness. *In re Gulfco Investment Corp.*, 593 F.2d 927, 19 Collier's Bankr.Cas. 758 (10th Cir. 1979); *Rhedom Realty Corp. v. Mammoth Mart, Inc.*, 397 F.Supp. 381 (D.Mass.1975).

In an attempt to buttress their position, the Kurtz Objectants argue that Grant's indebtedness to Grant Financial was not intended to constitute Senior Indebtedness. In support of that argument, reference is made to the prospectus issued by Grant dated April 7, 1971 in relation to the 4¾% Debentures. The failure of the prospectus to include intercorporate debt as part of then existing Senior Indebtedness is not controlling on this issue. The then outstanding indebtedness by Grant to Grant Financial in the amount of \$246,420,216 is includable in the definition of Senior Indebtedness as set forth in the 1971 Indenture. Curiously, the Kurtz Objectants urge that the description of Senior Indebtedness in the prospectus is controlling as to intercorporate indebtedness but not as to the inclusion of future borrowings as Senior Indebtedness.

The argument of the Kurtz Objectants is not persuasive. The definition of Senior Indebtedness as contained in the 1971 Indenture was incorporated by reference into the prospectus by the terms thereof. In those cases in which a conflict exists between an indenture and a prospectus, the indenture controls. In *In re Discon Corp.*, 346 F.Supp. 839, 844 (S.D. Fla. 1971), when confronted by a similar conflict, the Court stated:

It is the indenture which spells out the debenture agreement; the prospectus, in this case, merely summarized it. . . . By inadvertence or oversight certain rights of non-superior creditors were stated in the prospectus to exist which do not exist. The prospectus, however, cannot create these rights, for that is not its purpose. . . . [A]ny conflict must be resolved by reference to the indenture, incorporated by reference into the prospectus by the prospectus' own terms.

Accordingly, it is clear that Grant's indebtedness to Grant Financial would constitute Senior Indebtedness that would have to be satisfied in full from the bankrupt estate before any dividends could be paid to Subordinated Debentureholders. As stated, this would inure to the benefit of Bank Claimants. As a consequence, although the guarantee by Grant of Grant Financial's indebtedness in August 1974 may have represented the first direct obligation from Grant to the Bank Claimants, it did not materially improve the position of the Bank Claimants, *vis-a-vis* the subordinated Debentureholders.

Finally, as in prior proceedings in this bankruptcy case, the Kurtz Objectants contend that during the two year period prior to the filing of the Chapter XI petition by Grant, the Bank Claimants controlled and dominated the bankrupt's affairs to the detriment of Grant and its creditors. It is asserted that proof of such conduct would result in the equitable subordination of Bank Claims to the claims of the Subordinated Debentureholders. The Kurtz Objectants submit that the Trustee has erred by electing not to pursue this avenue. I am satisfied that the doctrine of equitable subordination offers little prospect of success and that the Trustee has acted on the basis of an informed judgment and in the best interests of the Subordinated Debentureholders in recommending the approval of the Offer.

The Trustee has recommended the Offer in light of the established principle that contractual subordination provisions do not offend the policy of equality of distribution of the assets of a bankrupt estate and will be enforced in accordance with their terms by bankruptcy courts. *In re Credit Industrial Corp.*, 366 F.2d 402 (2d Cir. 1966).<sup>2</sup> The record amply establishes that the Trustee weighed the probabilities of success as to the contentions of the Subordinated Debentureholders that the Bank Claims be equitably subordinated to the claims of all other creditors, including Debentureholders as well as the prospects of potential recoveries on behalf of the bankrupt estate insofar as they may relate to the claims of Subordinated Debentureholders. I agree with the Trustee.

A fundamental characteristic of the bankruptcy court is its expansive equitable powers. The doctrine of equitable subordination is a manifestation of such powers and provides a means of regulating distributions from a bankrupt estate by adjusting the hierarchy of creditors' claims to the equitable levels of the creditors' comparative claim positions. Its purpose is "to undo or to offset any inequity in the claim position of a creditor that will produce injustice or unfairness to other creditors in terms of the bankruptcy results." *In re Kansas City Journal-Post Co.*, 144 F.2d 791, 800 (8th Cir. 1944). The relief resulting from the application of said doctrine is remedial in nature and is generally limited to eradicating the results of overreaching or fraudulent conduct. *In re Mobile Steel Company*, 563 F.2d 692 (5th Cir. 1977).

Equitable subordination is an extraordinary remedy. In its application, the claim of one creditor may be subordinated to that of another creditor only to the extent necessary to offset injury or damage suffered by the creditor in whose favor the equitable doctrine may be effective. *Pepper v. Litton*, 308 U.S. 295, 304, 60 S.Ct. 238, 244, 84 L.Ed. 281 (1939). The power of equitable subordination may not be exercised in the absence of an injury to the other claimants. *Comstock v. Group of Institutional Investors*, 335 U.S. 211, 68 S.Ct. 1454, 92 L.Ed. 1911

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<sup>2</sup> This principle has been codified in Section 510(a) of the Bankruptcy Code, 11 U.S.C. §510(a), 92 Stat. 2549, 2586.

(1948); *In re Mobile Steel Company*, 563 F. 2d 692, 700 (5th Cir. 1977); *In re Branding Iron Steak House*, 536 F. 2d 299, 302 (9th Cir. 1976). The remedy of equitable subordination has been applied only sparingly and is not to be used unless the claimant sought to be subordinated (a) has acted in a fiduciary capacity; (b) has breached a fiduciary duty; (c) that breach resulted in detriment to those claimants to whom a duty was owed, *Comstock v. Group of Institutional Investors*, *supra*; *Farmers Bank of Clinton v. Julian*, 383 F.2d 314 (8th Cir.), *cert. denied*, 389 U.S. 1021, 88 S.Ct. 593, 19 L.Ed.2d 662 (1967); *Rader v. Boyd*, 252 F.2d 585 (10th Cir. 1957); *Dabney v. Chase Nat. Bank*, 196 F.2d 668 (2d Cir. 1952), *as supplemented*, 201 F.2d 635 (2d Cir.), *cert. dismissed per stipulation*, 346 U.S. 863, 74 S.Ct. 102, 98 L.Ed. 374 (1953); or (d) committed an act of moral turpitude, causing damages to other creditors, *In re Bowman Hardware & Electric Co.*, 67 F.2d 792 (7th Cir. 1933).

The standards governing the application of the doctrine of equitable subordination are not precisely defined and each case is dependent upon its peculiar facts. It is established, however, that in applying such doctrine the burden of proof will differ according to the relationship of the creditor and the debtor. With respect to a non-insider creditor's conduct, the standard of misconduct that would have to be demonstrated to justify equitable subordination is very substantial. As stated by the United States Court of Appeals for the Seventh Circuit in *In re Bowman Hardware & Electric Co.*, 67 F.2d 792, 794 (1933):

Before a general creditor's claim against the bankrupt may be disallowed or its status lowered, it must appear that said creditor has been guilty of some act involving moral turpitude or some breach of duty or some misrepresentation whereby other creditors were deceived *to their damage*. In the instant case the absence of any evidence that other creditors were damaged by appellant's action, conceding for the moment that such action amounted to fraud, is fatal to the asserted priority of all other general creditors save Van Camp Hardware and Iron Company. [citing cases]

A creditor is under no fiduciary obligation to its debtor or to other creditors of the debtor in the collection of its claim.

*Farmers Bank of Clinton v. Julian, supra; Rader v. Boyd, supra; Crowder v. Allen-West Commission Co.*, 213 F. 177 (8th Cir. 1914). As stated in *Rader*:

A confidential relationship is never presumed and the burden is upon the party asserting it \* \* \*. Parties may assuredly deal at arm's length for their mutual benefit without raising a confidential relationship between them \* \* \*. It may be that his conduct did not conform to the highest ethical standards, but having no fiducial relationship, his duty arose no higher than the morals of the market place. 252 F.2d at 587

Even in the situation where a creditor exercises a significant degree of daily monitoring of its debtor, the application of equitable subordination has been denied. *Crowder v. Allen-West Commercial Co.*, 213 F. 177 (8th Cir. 1914); *Ingram v. Lehr*, 41 F.2d 169 (9th Cir. 1930).

In *Farmers Bank of Clinton v. Julian, supra*, the court refused to apply equitable subordination to the claims of a bank, stating that "subordination \* \* \* is usually exercised against corporate insiders who take advantage of their position and knowledge to defraud creditors," and further:

In the case at bar \* \* \* the Bank \* \* \* had no interests in the bankrupt's operation, except as a creditor supplying the normal banking services of accounts and loans to the bankrupt. There is absolutely no evidence of any fraud or unfair dealing. The Bank went to lengths to aid and assist the bankrupt in his operations and should not be penalized for trying to help the bankrupt keep intact his business. No other creditors were misled or suffered any damage by reason of the Bank extending credit.

383 F.2d at 322, 323.

The difficulty of sustaining a claim of equitable subordination even against an insider-creditor who has a fiduciary responsibility to act in the best interests of the bankrupt is demonstrated by a recent decision of the United States Court of Appeals for the Tenth Circuit. *In re Mid-Town Produce Terminal, Inc.*, 599 F.2d 389 (1979). In that case, the Court of

Appeals refused to subordinate loans by a dominant shareholder to a failing corporation. The court held that the mere transaction of a secured loan transaction between the insider and the bankrupt *per se* did not warrant the subordination of the insider's claim. Rather, the Court of Appeals determined that there would have to be a showing of "fraud or sharp dealing" before any equitable subordination of the controlling shareholder's claim.<sup>3</sup>

In order to equitably subordinate the claims of non-insiders, a greater burden must be sustained. It must be established that the holder of the claim to be subordinated committed fraud, overreaching or spoliation to the detriment of others. A mere statement that the creditor is guilty of "inequitable conduct" will not suffice. *In re Prima*, 98 F.2d 952 (7th Cir. 1938); *In re Process-Manz Press, Inc.*, 236 F. Supp. 333 (N.D. Ill. 1964), *Rev'd on jurisdictional grounds*, 369 F.2d 513 (7th Cir. 1966), *cert. denied sub nom., Limperis v. A. J. Armstrong Co., Inc.* 386 U.S. 957, 87 S.Ct. 1022, 18 L.Ed.2d 104.

The *Prima* case is particularly instructive. In that case, a trustee sought to recover payments made to two secured bank lenders. It was alleged that the banks had mismanaged the bankrupt through the agency of one Skinner, the General Manager, who was allegedly hired as a result of bank threats to call their loans. The trustee in that case claimed that the activities of the banks amounted to overreaching to the detriment of the bankrupt and its other creditors. The Court of Appeals rejected the contention that Skinner was the agent of the banks and determined that the activities of the banks had been limited to recommending that a manager be appointed to deal with the bankrupt's problems. Significantly, in that case it was determined that no fiduciary relationship existed between the bankrupt and its bank creditors and, therefore, a threat to call or demand payment of outstanding loans did not constitute

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<sup>3</sup> See also *In re Virginia Dinner Theater, Inc., a/k/a Cavalier Dinner Theater*, CCH Bankr.L.Rep. ¶ 67,232 (E.D. Va. B 78-356-N, July 24, 1979) reversing the bankruptcy court's subordination of the claim of insider creditor.

overreaching but rather the exercise of a legal right. As the court stated:

Aside from the provisions of the bankruptcy law, a creditor has a right to call a loan when due and to lawfully enforce collection. *He may refuse an extension for any cause which may seem proper to him, or even without any cause. The law provides certain means for the enforcement of claims by creditors. The exercise of those rights is not inherently wrongful.*

\* \* \*

No doubt the debtor, because of its inability to meet its maturing obligations, acquiesced in [the bank's] recommendations, but this we think is not sufficient to constitute domination of its will.

98 F.2d at 965. (Emphasis added).

As to the degree of control necessary to provide a basis for the equitable subordination of a non-insider's claim, the *Process-Manz* case, *supra*, is pertinent. In that case, a non-insider creditor so dominated and controlled the bankrupt that the court treated it as the equitable owner of the bankrupt, subject to fiduciary responsibilities, rather than that of an arm's-length creditor. The evidence in that case established that the creditor had fraudulently obtained over 90% of the debtor's stock and controlled 100% of its income. The subordination of the claims was predicated upon the unfair, inequitable and fraudulent conduct of the creditor to the detriment of the bankrupt. In the case at bar, there is no evidence that the conduct of the Bank Claimants even remotely approaches the extent of the misconduct of the creditor in *Process-Manz*.

I am satisfied that in the case of Grant the transactions between the Bank Claimants and Grant are the result of arm's-length negotiations conducted in good faith and governed by the dictates of sound business judgment. I have reviewed the evidence and, in particular, the portions of testimony elicited in examinations pursuant to Bankruptcy Rule 205(a) which the Kurtz Objectants claim establish control and domination on the part of the Bank Claimants. The excerpts referred to by the

Kurtz Objectants constitute but a small portion of the vast amount of information, facts and materials considered by the Trustee. To a considerable extent, the "facts" presented by the Kurtz Objectants are based upon hearsay testimony, distortions of testimony, out-of-context statements or misstatements.<sup>4</sup>

The record establishes the converse. It appears that the actions taken by Grant reflected independent policy decisions and not rigid submission to the dictates of the Bank Claimants. Mr. Sundman, a chief financial officer of Grant who had been

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<sup>4</sup>For example, the Kurtz Objectants assert as a "fact" which the "Trustee fails to disclose" that the proposed sale of a portion of Grant's customer accounts receivable did not go through in July of 1974 "because DeWitt Peterkin, Vice Chairman of Morgan Guaranty, who was also a director, Chairman of the Audit Committee and a member of the Executive Committee of Grant, advised the Board of Directors that the banks were opposed to the sale." (Kurtz Proposed Findings of Fact Para. 49(j)). The testimony cited by the Kurtz defendants in support of this statement reflects that it was Mr. Pierson who advised the board that two of the major bank lenders opposed the sale. (Kelly Examination 78-80). This testimony is insufficient to support Kurtz's conclusion that the Bank Claimants prevented the proposed sale from going forward. In fact, neither Messrs. Pierson nor Luckett could recall Mr. Peterkin ever having any involvement in the proposed transaction.

The Kurtz Objectants further imply that Mr. Peterkin participated in discussions as to the "\$600,000,000 bank loan." (Kurtz Proposed Findings of Fact Para. 49(p)). In fact, the testimony cited by Kurtz relates to the initial discussion of the \$100,000,000 term loan in mid-1973. Whereas Kurtz suggests that Mr. Peterkin participated in loan negotiations with the banks, the very testimony cited (and the testimony contained in the immediately preceding transcript pages) is to the contrary. Mr. Curtin testified that Mr. Peterkin was a "dedicated outside director" who was very much aware of "his relationship with the bank" and took no part on the banking side of Grant other than getting the right people together. (Curtin Examination 1004, 1006). He further testified that Mr. Peterkin did not get involved in the discussions with the banks of matters relating to financing the company and concluded that Mr. Peterkin "would never impinge or be put in the position where he was acting with two hats." (Curtin Examination 1009, 1012, 1014).

A further example of the disregard for the record is the description of what he purports to be testimony by Mr. Kelly that the "banks were running the company." (Kurtz Proposed Findings of Fact Para. 49(aa) and (bb)). This testimony in fact shows that Mr. Kelly did not recall saying that the banks were running Grant, that he denied that they were running the company, and that he had not said and would

appointed a director in 1974, testified that he operated without instructions from the Bank Claimants and that the advisory group organized by the Bank Claimants in 1974 offered neither suggestions nor opinions as to the business operations of Grant. There has been no evidence introduced by the Kurtz Objectants which would tend to establish that the Bank Claimants prevented Grant from initiating a proceeding under the Bankruptcy Act in 1974 or 1975. The record demonstrates that prior to the decision made by the Grant Board of Directors during the end of September 1975 to seek relief under the Bankruptcy Act, both the Bank Claimants and Grant management viewed Grant as a turn-around situation and not insolvent.

Accordingly, it must be concluded that the probabilities of success as to the prosecution of claims of equitable subordination are very remote. In that context, the Trustee's recommendation is well founded. Although afforded every opportunity in this proceeding and others in this case, neither Mr. Kurtz nor his representative has produced a scintilla of evidence which would demonstrate a probability of success in relation to the subordination of the Bank Claims.

Finally, in connection with this subject, I acknowledge that post-bankruptcy purchasers of debt securities of an entity in bankruptcy obtain allowable claims equal to the face amount of such securities, provided that such purchasers owe no fiduciary obligations to the debtor, other creditors or shareholders of the debtor, and have not acquired the debt securities through fraud, misrepresentation or any other form of overreaching. *In re Lorraine Castle Apartments Bldg. Corporation*, 149 F.2d 55 (7th Cir.), *cert. denied*, 326 U.S. 728, 66 S.Ct. 35, 90 L.Ed. 432 (1945); *In re Franklin Bldg. Co.*, 178 F.2d 805 (7th Cir. 1949), *cert. denied*, 339 U.S. 978, 70 S.Ct. 1023, 94 L.Ed. 1383 (1950); *Moulded Products, Inc. v. Barry*, 474 F.2d 220 (8th Cir.), *cert. denied*, 412 U.S. 940, 93 S.Ct. 2779, 37 L.Ed.2d 400 (1973); *In re V-I-D, Inc.*, 101 F. Supp. 71 (N.D. Ind. 1951), *aff'd*, 198 F.2d 392 (7th Cir. 1952), *cert. denied*, 344 U.S. 914, 73 S.Ct. 337, 97 L.Ed. 705 (1953); *In re Automatic Equipment Mfg. Co.*, 106

not say that people said the banks were running the company because the distinction between the banks' role and running the company was a grave one. (Kelly Examination 82-85).

F.Supp. 699 (D. Neb. 1952), *app. dismd.*, 202 F.2d 955 (8th Cir. 1953); *In re Celotex Co.*, 12 F.Supp. 1 (D. Del. 1935); *In re Indiana Central Telephone Co.*, 24 F.Supp. 342 (D.Del. 1938); *In re Philadelphia & Western Ry. Co.*, 64 F.Supp. 738 (E.D. Pa. 1946); 8B C.J.S. Bankruptcy §936.

However a question remains as to the standing of purchasers of debt securities to assert extrinsic claims over and beyond the debt securities. The availability of equitable subordination might be found to belong only to the transferors and constitute an extrinsic claim or entirely different issue than the collection of the face amount of the debt security as a contractual obligation. This is particularly pertinent in the case at bar inasmuch as it has been established that Mr. Kurtz acquired his 4¾% Debentures months after the commencement of Grant's Chapter XI case and that he continued to purchase 4¾% Debentures after Grant was adjudged a bankrupt on April 13, 1976 and the Trustee had filed his answer and counterclaims in the adversary proceeding commenced by the Bank Claimants. This is probably true with one or more of the Kurtz Objectants as well as other Subordinated Debentureholders. As stated above, the equitable power to subordinate claims of one creditor to those of another may not be exercised in the absence of injury to the other creditor. It is difficult to perceive injury on the part of Subordinated Debenture holders who purchased their Debentures after the alleged misconduct of the Bank Claimants, the intervention of bankruptcy and at distressed prices.

It, therefore, appears that the doctrine of equitable subordination may not be asserted by persons such as Mr. Kurtz who purchased their claims against the bankrupt after the alleged misconduct of the Bank Claimants. Conceivably, State law may control what rights pass with the transfer of debentures. For example, under the General Obligations Law of the State of New York, Section 13-107(1), unless expressly reserved in writing, a transfer of any bond vests in the transferee all claims or demands of the transferor, whether or not such claims or demands are known to exist (a) for damages or rescission against the obligor [Grant] on such instrument, (b) for damages against the trustee or depository under any indenture under which such bond was issued or outstanding, and (c) for damages

against any guarantor of the obligations of such obligor, trustee or depositary. Section 13-107(1) does not provide for a transfer of claims of the transferor against anyone other than the persons in the three specifically identifiable categories. The Bank Claimants are not within the ambit of the three categories of a transferor's claims which would pass to a transferee by operation of law. *Cf. In re Four Seasons Nursing Centers of America, Inc.*, 472 F.2d 747 (10th Cir. 1973); *Bateson v. Magna Oil Corp.*, 414 F.2d 128 (5th Cir. 1969), *cert. denied*, 397 U.S. 911, 90 S. Ct. 909, 25 L.Ed.2d 91 (1970); *Blum v. Morgan Guaranty Trust Co. of New York*, 539 F.2d 1388 (5th Cir. 1976).

The record overwhelmingly supports the Trustee's evaluation as to the probable success of the prosecution of the claims of equitable subordination. The probability of success is minimal. Additionally, the cost of such dubious pursuit would be substantial and inimical to the administration of the bankrupt estate. There is no basis for incurring the cost of such a highly speculative venture particularly in light of the alternative of the approval of the Offer.

The Kurtz Objectants also argue that the terms of the Offer in respect of the release of Chase requires the disapproval of the Trustee's application. I find no support for the allegations of the Kurtz Objectants that Chase as Predecessor Indenture Trustee breached its fiduciary responsibilities to the 4¾% Subordinated Debentureholders. The record reflects that the Trustee reviewed the files of Chase in respect of its activities as Indenture Trustee and I have carefully scrutinized the testimony of the Chase officer who was deposed by counsel for the Kurtz Objectants. That testimony establishes that Chase resigned to avoid any perception of conflict with the Subordinated Debentures. Subsequent to its resignation, Chase increased its loans and advances in connection with the bankrupt in apparent belief that Grant's financial problems were temporary and that it would effect a total recovery. As stated in *Morris v. Cantor*, 390 F.Supp. 817 (S.D.N.Y. 1975) " \* \* \* the mere existence or creation of a dual relationship, as trustee under [an] indenture and as preferred creditor of the obligor on the bonds" is not a *per se* breach of fiduciary responsibility to debentureholders under the Trust Indenture Act of 1939. *Ibid.* at 823.

Liability to debentureholders only will result from "willful misconduct", a very high standard constituting "knowing, intentional action in flagrant disregard of the interests of bond holders." *Ibid.* at 824. Such conduct or action was not found in *Morris v. Cantor, supra*, and no information or evidence has been presented in this case to indicate probable establishment of such conduct or action on the part of Chase. It would be improvident for me to deny the Trustee's application on the basis of unsupported charges of the Kurtz Objectants.

(b) *"Difficulties, if any," with respect to "Collection"*.

There will be no difficulty in collecting a judgment or obtaining appropriate relief in connection with the successful litigation of claims. The record demonstrates that pursuant to a stipulation dated May 10, 1978 among the Trustee, Morgan Guaranty and U.S. Trust, the rights of Subordinated Debentureholders and the Bank Claimants have been preserved and funds are available to satisfy any potential judgment or determination of the respective rights. However, the Trustee has demonstrated that any litigation will require a substantial amount of time and offers little hope for success. Consequently the full litigation of such remote claims would necessarily impair the ability of the Trustee to discharge his duties under Section 47 of the Bankruptcy Act, 11 U.S.C. § 75, as to the collection, liquidation and closing of the administration of the bankrupt estate "as expeditiously as is compatible with the best interests of the parties \* \* \*".

(c) *The "complexity" and "expense" of the litigation.*

The complexities of prosecuting the claims of equitable subordination against the Bank Claimants are obvious. The litigation presents sharply disputed issues of fact and law and imprecise standards to be applied. All litigation is time consuming and expensive and the proposed litigation would be even more so.

(d) *"The paramount interest of creditors"*.

The record demonstrates that if the Offer is rejected and the Subordinated Debentureholders are unsuccessful in any

attempt to vitiate the subordination provisions they will not participate in any recovery from the assets of the bankrupt estate. The Kurtz Objectants consist of approximately 2% of the outstanding principal amount of the 4<sup>3</sup>/<sub>4</sub>% Debentures and one (1) holder of approximately 8% of the outstanding principal amount of the 4% Debentures. The respective Indenture Trustees support the approval of the Offer and its dissemination. The attempts on the part of Mr. Kurtz to incite large scale opposition to the Offer have been unsuccessful. I find that the paramount interest of the creditors justifies approval of the Offer.

Although I do not read *TMT Trailer Ferry, supra*, as requiring me to conduct the equivalent of a trial on the merits before being in a position to determine whether the approval of an offer of compromise and settlement is warranted, I find that the Trustee has conformed with the requirements of that case as well as those stated in *In re Blair, supra*. See also, *Florida Trailer & Equipment Co. v. Deal*, 284 F.2d 567 (5th Cir. 1960); *In re Riggi Bros.*, 42 F.2d 174 (2d Cir.), *cert. denied sub nom.*, *Wood & Selick, Inc. v. Todd*, 282 U.S. 881, 51 S.Ct. 85, 75 L.Ed. 777 (1930); *Newman v. Stein*, 464 F.2d 689 (2d Cir.), *cert. denied*, 409 U.S. 1039, 93 S.Ct. 521, 34 L.Ed.2d 488 (1972); *Saylor v. Lindsley*, 456 F.2d 896 (2d Cir. 1972); *Flinn v. FMC Corp.*, 528 F.2d 1169 (4th Cir. 1975), *cert. denied*, 424 U.S. 967, 96 S.Ct. 1462, 47 L.Ed.2d 734 (1976); *In re Tubotron*, 3 Bankr.Ct. Dec. 525 (S.D.N.Y. 1977).

The record is more than adequate to enable me to make an informed and reasoned judgment in relation to the Trustee's application. None of the objectants has established any meaningful basis upon which to preclude the consideration of the Offer by Subordinated Debentureholders. As previously determined by this Court, objectants cannot stand in the way of a compromise and settlement by simply objecting thereto and resting. This principle was enunciated by the United States Court of Appeals for this circuit in *Detroit v. Grinnell Corp.*, 495 F.2d 448 (1974):

[The objectants] have not even attempted to make such a showing. Their sole complaint is that [the proponents of the settlement] have not proven that each of the claimants had

actual or constructive knowledge of the fraudulent concealment. However, the burden of proof is upon [objectants] and not upon [the proponents]. Needless to say, they have neither carried nor attempted to carry this burden. . . . They exclaim with some indignation that "there is not an iota of evidence and none is cited by defendants to support their bold assertion that the 'concealment ended' in 1953. . . ." Since *no [objectant] has ever tendered any proof to the effect that fraudulent concealment persisted after 1953, that issue must be considered as settled in favor of [the proponents]*.

*Id.* at 461 (Emphasis added).

In the same opinion, the Court of Appeals also stated:

[The objectant] claims that since the proponents of the settlement have the burden of justifying it to the satisfaction of the trial court, it remains [the proponents'] duty to produce documents and other evidence to substantiate the offer. [The objectant] apparently feels that he may sit back and request the production of documents that have already been produced [during discovery] . . . .

In general, the position taken by the objectors is that by merely objecting, they are entitled to stop the settlement in its tracks, without demonstrating any factual basis for their objections, and to force the parties to expend large amounts of time, money and effort to answer their rhetorical questions, notwithstanding the copious discovery available from years of prior litigation and extensive pre-trial proceedings. *To allow the objectors to disrupt the settlement on the basis of nothing more than their unsupported suppositions would completely thwart the settlement process. On their theory no class action would ever be settled, so long as there was at least a single lawyer around who would like to replace counsel for the class and start the case anew.* To permit the objectors to manipulate the distribution of the burden of proof to achieve such an end would be to permit too much. *Although the parties reaching the settlement have the obligations to support their conclusion to the satisfaction of the District Court, once*

*they have done so, they are not under any recurring obligation to take up their burden again and again ad infinitum unless the objectors have made a clear and specific showing that vital material was ignored by the District Court.*

*Id.* at 464 (Emphasis added). See also, *Feder v. Harrington*, 58 F.R.D. 171 (S.D.N.Y. 1972).

The record is devoid of any showing that the Trustee has erred in his evaluation of the facts or the law as it applies to the controversy. The contentions of the Kurtz Objectants are insufficient and grossly inadequate to block the dissemination of the Offer and the affording of an opportunity to Subordinated Debentureholders to realize some return upon their claims.

#### **THE CLAIMED DISQUALIFICATION OF THE TRUSTEE, U.S. TRUST, AND THEIR ATTORNEYS**

Despite the Kurtz Objectants' failure to demonstrate error or any defect in the Trustee's evaluation, in an effort to deprive Subordinated Debentureholders of the opportunity to accept or reject the Offer, the Kurtz Objectants attack the qualifications of the Trustee, his attorneys, U.S. Trust and its attorneys. The record reflects the evolution of events which have resulted in the attacks made by the Kurtz Objectants and, particularly, Mr. Kurtz. It is self-evident that the precipitating cause for the attacks is the refusal by the Trustee, his attorneys, U.S. Trust and its attorneys to blindly follow the advice and instructions of Mr. Kurtz. At such times as the Trustee and his attorneys were pursuing areas of activity which coincided with Mr. Kurtz' desires there were no claims of disqualification or conflicts of interest. Indeed, Mr. Kurtz was quite complimentary of the Trustee and his attorney at those times. However, rejection of Mr. Kurtz' advice has led to the instant claims of disqualification and conflicts of interest, the filing of a grievance complaint against the Trustee's attorney and the threat to file a similar grievance complaint against the attorneys for U.S. Trust. Unfortunately motions to disqualify adversaries and add them as parties to an action are "\* \* \*" simply a tactical maneuver designed in bad faith "\* \* \*" and often "\* \* \*" represent the culmination of a pattern of highly improper conduct [based upon] making baseless and unjustified personal and professional

attacks upon numerous reputable persons involved in the case, including counsel for various parties and district judges." *Lowenschuss, et al. v. Bludhorn, et al.*, 613 F.2d 18, 20 (2d Cir. 1980). I find no merit or substance in the allegations made by the Kurtz Objectants.

(a) *The Trustee*

Prior to his appointment and qualification as the Trustee of this bankrupt estate, Charles G. Rodman was the Chairman of the Board of Directors and Chief Executive Officer of the Grand Union Company. Mr. Rodman had been employed by the Grand Union Company for 24 years. The Kurtz Objectants charge that Mr. Rodman is disqualified from further participation in this proceeding because his name was submitted as a candidate for standby trustee in the Chapter XI case by a representative of Chase. Mr. Rodman's name as a candidate for standby trustee was one of several submitted for the consideration by the Statutory Creditors' Committee in the Chapter XI case. He was elected by creditors as the standby trustee in the Chapter XI case under Bankruptcy Rule 11-27.

The Kurtz Objectants argue that because Mr. Rodman was nominated for consideration by Chase, a Bank Claimant, and that the Grand Union Company had once borrowed funds from Chase, he must be disqualified from acting as trustee in this case. The argument is without merit.

On April 13, 1976 when Grant was adjudged bankrupt, Mr. Rodman qualified as the trustee in bankruptcy. At the time of his qualification he was interrogated by me as to his qualifications and the circumstances pursuant to which he was nominated and elected as a standby trustee. He detailed his contacts with Chase. The testimony which Mr. Rodman gave on April 13, 1976 satisfied me that he would independently and objectively discharge and perform the duties of a trustee under the Bankruptcy Act.

Section 44a of the Bankruptcy Act, 11 U.S.C. §72a and Bankruptcy Rule 209(a) confer upon the creditors of a bankrupt estate the right to elect a trustee in bankruptcy. In the case at bar the election of Mr. Rodman as Trustee conformed in all

respects with the provisions of the Bankruptcy Act and Rules of Bankruptcy Procedure. It is axiomatic that the mere fact that an individual or entity is nominated and elected as a trustee or standby trustee by a creditor of the bankrupt does not result in the creation of a conflict of interest or a basis for disqualification of the elected Trustee. *In re Mayflower Hat Co.*, 65 F.2d 330 (2d Cir. 1933); *In re Eloise Curtis, Inc.*, 326 F.2d 698 (2d Cir. 1964). As the Court of Appeals for this Circuit stated in *In re Freeport Italian Bakery, Inc.*, 340 F.2d 50, 54 (2d Cir. 1965):

Potential conflicts of interest do not of themselves disqualify creditors from being appointed trustees in bankruptcy, even when they have already acted as a receiver, assignee for the benefit of creditors, or reorganization trustee, i.e., in capacities in which they must account to the bankruptcy court for their stewardship of the bankrupt's estate. *In the Matter of G.E.C. Securities, Inc.*, 331 F.2d 655 (2d Cir. 1964); *In the Matter of Eloise Curtis, Inc.*, 326 F.2d 698 (2d Cir. 1964). See also *Schwartz v. Mills*, 192 F.2d 727, 29 A.L.R.2d 1161 (2d Cir. 1951). "The fact that \* \* \* is a nephew-in-law and cousin of the two presidents of the bankrupt corporation does not of itself disqualify \* \* \* from voting for or being appointed as trustee. Grounds for disapproval or removal of a trustee in bankruptcy are not to be found in his formal relationships. "[W]e have traditionally stressed the elements of fraud and actual injury to the debtor interests \* \* \*. *Schwartz v. Mills, supra*, 192 F.2d at 729.

I am satisfied that Mr. Rodman has demonstrated no bias against any group of creditors during his stewardship of the bankrupt estate over the past three and three-quarters years.

The record establishes that he has conducted a thorough examination of the relationship of the Bank Claimants with Grant. He successfully negotiated the Bank Settlement Agreement which significantly reduced the dividends that the Bank Claimants might otherwise have received and which resulted in material benefits to other creditors. The request of the Kurtz Objectants that the Trustee be disqualified is denied.

(b) *The Trustee's Attorneys.*

The attack made by the Kurtz Objectants as to Weil, Gotshal & Manges, attorneys for the Trustee ("WGM"), merits a similar fate. It is a cardinal principle of bankruptcy administration that a trustee in bankruptcy is entitled to engage attorneys of his choice, subject only to the approval of the court. *In re Magna Products Corp.*, 251 F.2d 423, 424 (2d Cir. 1957); *In re Columbia Iron Works*, 142 F. 234 (E.D.Mich. 1904). Disqualification of a trustee's attorneys requires considerable reluctance inasmuch as disqualification has an immediate adverse effect on the administration of a bankrupt estate and because such motions are often interposed for tactical purposes, as aforesaid. *Board of Educ. v. Nyquist*, 590 F.2d 1241, 1246 (2d Cir. 1979); *Lowenschuss, et al. v. Bludhorn, et al.*, *supra*.

The Kurtz Objectants contend that WGM must be disqualified because they allegedly represented the Bank Claimants in their prosecution of their claims against Grant. The record establishes the contrary. WGM had no involvement in connection with Grant or with any Bank Claimant as to its claims against Grant until October 9, 1975 — just five (5) days prior to that firm's engagement by the Creditors' Committee of the Grant estate. After the retention of WGM by the Creditors' Committee in the Chapter XI case, they specifically refused employment by any of the Bank Claimants in relation to the prosecution of claims against Grant. Throughout this case the Bank Claimants have been represented by other attorneys. Further, WGM's engagement by the Trustee is consistent with Section 44 of the Bankruptcy Act, 11 U.S.C. § 72c, which provides:

An attorney shall not be disqualified to act as attorney for the receiver or trustee merely by reason of his representation of a general creditor.

See also Bankruptcy Rule 215(c).

The Kurtz Objectants also contend that the representation by WGM of certain banks, who are also Bank Claimants, pursuant to special engagements as to matters totally apart from the instant bankruptcy case, requires their disqualification. In this connection it is urged that WGM's representation of First

Pennsylvania Bank, N.A. and Flushing Savings Bank in unrelated matters is sufficient to disqualify WGM even though those institutions are not creditors of the bankrupt estate.

The Kurtz Objectants focus upon the special representation by WGM of Morgan Guaranty as a creditor in a separate and distinct Chapter XI case before another bankruptcy judge from February 1975 until April 4, 1977 as an absolute ground for disqualification. It is also asserted that WGM's role as co-counsel to the Chapter XI Creditors' Committee constitutes a disqualification factor.

This Court recently had the opportunity to review the factors to be considered in entertaining a motion to disqualify attorneys for a trustee in *In re REA Holding Corp.*, 4 Bankr.Ct.Dec. 1249 (S.D.N.Y. 1979). The disqualification of both a trustee and his co-counsel was sought upon alleged conflicts of interest which prevented them from adequately representing the interests of the bankrupt estate. Among the alleged conflicts cited was the fact that the counsel for the trustee had represented the Creditors' Committee during the Chapter XI case that preceded an adjudication in bankruptcy and the retention of such counsel by the trustee. In considering that motion I was guided by the teachings of *Emle Industries, Inc. v. Patentex, Inc.*, 478 F.2d 562 (2d Cir. 1973). *Emle* admonishes courts to recognize their "responsibility to preserve a balance, delicate though it may be, between an individual's right to his own freely chosen counsel and the need to maintain the highest ethical standards of professional responsibility." 4 Bankr.Ct.Dec. at 1253 (citation omitted). Additionally, I noted the difficulties involved in evaluating the claims asserted in the perspective of the guidelines provided by *United States v. Standard Oil Company*, 136 F.Supp. 345, 367 (S.D.N.Y. 1955), which states:

When dealing with ethical principles, it is apparent that we cannot paint with broad strokes. The lines are fine and must be so marked. Guideposts can be established when virgin ground is being explored, and the conclusion in a particular case can be reached only after painstaking analysis of the facts and precise application of precedent.

I concluded and reaffirm that "[t]he role of counsel to an official creditors' committee is not adverse to or in conflict with the role of counsel to a bankruptcy trustee if liquidation should subsequently ensue." 4 Bankr.Ct.Dec. at 1253.

As for the representation of a creditor of the bankrupt estate in an unrelated and distinct matter, such representation does not result in a *per se* disqualification of an attorney for a trustee. It has been the customary and accepted practice. Cf. Section 44c of the Bankruptcy Act, *supra*, Bankruptcy Rule 215(c).<sup>5</sup> WGM has not represented any Bank Claimant in the prosecution of its claim against Grant. The Kurtz Objectants have failed to provide any evidence tending to establish any basis for disqualifying WGM as attorneys for the Trustee. I have reviewed the record and I am satisfied that the Trustee's attorneys have served him and the creditors of the bankrupt estate with vigor, objectivity and independence. I conclude that there exists no basis for the disqualification requested.<sup>6</sup>

It is alleged by the Kurtz Objectants that the hearing must be considered a nullity on the basis that the Trustee's attorney testified in connection with the merits of the Offer. This claim warrants no further consideration by the Court inasmuch as it has heretofore been addressed in *In re W. T. Grant Company*, 75 B 1735 (S.D.N.Y. Jan. 18, 1978). In that proceeding to which

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<sup>5</sup>Codification of this customary and accepted practice is found in Section 327 of the Bankruptcy Code, 11 U.S.C. §327, 92 Stat. 2549, 2563, which relates to the engagement of professionals. Section 327(c) states:

(c) In a case under chapter 7 [liquidation] or 11 [reorganization] of this title, a person is not disqualified for employment under this section solely because of such person's employment by or representation of a creditor, but may not, while employed by the trustee, represent, *in connection with the case*, a creditor.

Emphasis added.

<sup>6</sup>It is noted that I. Walton Bader, an attorney for Mr. Kurtz, in a letter addressed to the court dated April 25, 1978, disassociated himself from Mr. Kurtz' position as to a conflict of interest on the part of WGM. He stated:

We wish to inform the Court that we do not support Mr. Kurtz' position in this matter, that Harvey Miller or the firm of Weil, Gotshal & Manges is not entitled to represent the Trustee before your Honor because of any alleged conflict of interest.

Mr. Kurtz was a party and Mr. Bader appeared, I concluded that the testimony of an attorney for the Trustee in relation to the consideration of a compromise and settlement is warranted and properly part of the record of such proceeding. The Kurtz Objectants misconceive the nature of a hearing to consider a compromise and settlement. The evaluation of legal issues involved in the controversy is a material element to the consideration of a proposed compromise and settlement. Obviously, the claimed inability of a trustee's attorney to testify as to legal issues involved "would work a substantial hardship on the [trustee] because of the distinctive value of a lawyer or his firm as counsel in the particular case." Furthermore, this contention of the Kurtz Objectants is patently frivolous in light of the repeated statements made by their attorney of his intention to call the Trustee's attorney as a witness during the hearing. The contention is without merit and is rejected.

(c) *U.S. Trust and Its Attorneys.*

The Kurtz Objectants have demonstrated no basis upon which it would be proper to disqualify U.S. Trust and its attorneys. I am satisfied that U.S. Trust has adequately represented the interests of the 4¾% Subordinated Debentureholders since the commencement of the bankrupt case. U.S. Trust and its attorneys actively participated in the investigation of the Bank Claimants by the Trustee. In connection with the compromise and settlement of the claims of Secured Suppliers of Grant, holders of Grant 4¾% Sinking Fund Debentures and the Bank Claimants, U.S. Trust was heavily involved. The assertion by the Kurtz Objectants that U.S. Trust is subject to disqualifying conflicts of interests because of other business relationships with Chase and one or more of the Bank Claimants is not substantiated by the record. There is no evidence that U.S. Trust has been negligent or otherwise deficient in the discharge of its responsibilities as Indenture Trustee for the 4¾% Subordinated Debentures. Disqualification of an Indenture Trustee and its attorneys may not be granted on the basis of

unsupported and ephemeral assertions. Accordingly, the position of the Kurtz Objectants as to U.S. Trust and its attorneys is rejected.

I have considered all of the assertions made on behalf of the Kurtz Objectants. I find nothing in the record which would tend to support any of the assertions, contentions and charges which have been made by the Kurtz Objectants. They are without substance and should not serve to prejudice the interests of other Subordinated Debentureholders who by reason of the approval of the Offer will be afforded the opportunity to realize a recovery upon their claims. If the Offer becomes effective, up to approximately \$14,000,000 will be distributed from the assets of the bankrupt estate for the benefit of Subordinated Debentureholders. The Offer provides material benefits to the creditors of the bankrupt estate, its acceptance would substantially contract any litigation of the sharply disputed issues of fact and law relating to the controversy and the administration of the bankrupt estate. In light of the probabilities of success the Offer is in the best interests of the bankrupt estate and its creditors. Accordingly, I approve the Offer and authorize its dissemination to Subordinated Debentureholders.

The Trustee is directed to proceed in accordance with the terms and provisions of the Offer, this Opinion and further to furnish to all known Subordinated Debentureholders (a) a copy of his application, as amended; (b) a copy of this Opinion; and (c) such other papers and documents as are contemplated by the Offer.

The foregoing constitutes the findings and conclusions of the Court in accordance with Bankruptcy Rule 752.

No finding of fact or conclusion of law made with respect to the Trustee's application, the application made by the Trustee and filed April 10, 1978 as to the compromise and settlement of the controversy with the Bank Claimants, or the Bank Settlement Agreement, or the testimony received at the hearings in

connection with the applications shall be admissible in evidence for any purpose other than for purpose of impeachment, in any subsequent action or proceeding if the Offer does not become effective or concerning the rights of non-accepting Subordinated Debentureholders.

IT IS SO ORDERED.

Dated: New York, New York  
February 20, 1980

/s/ John J. Galgay

*Bankruptcy Judge*

IN THE  
**Supreme Court of the United States**

OCTOBER TERM, 1982

No. 82-1985

In re  
W. T. GRANT COMPANY,

*Bankrupt.*

DAVID COSOFF and HELEN FINKELSTEIN,  
*Petitioners,*

-against-

CHARLES G. RODMAN, as Trustee of the  
Estate of W. T. GRANT COMPANY, Bankrupt,  
*Respondent.*

ON PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES  
COURT OF APPEALS FOR THE SECOND CIRCUIT

**BRIEF OF RESPONDENT UNITED STATES TRUST  
COMPANY OF NEW YORK IN OPPOSITION TO  
PETITION FOR A WRIT OF CERTIORARI**

JAMES C. SARGENT, ESQ.  
*Attorney for Respondent*  
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## QUESTIONS PRESENTED

I. Should the Court grant the petition for a writ of certiorari (the "Petition") in this case where the Petitioners have failed to show that there are special and important reasons therefor, as required by Rule 17 of the Rules of this Court?

II. Did the Court of Appeals apply the correct standard for reviewing an order approving a settlement of a suit in the Bankruptcy Court?

III. Should the order approving a settlement of claims in the Bankruptcy Court be reversed on the grounds that the attorney for the bankruptcy trustee is accused of having a conflict of interest, where the trial court and the reviewing courts found no truth in those allegations and where the beneficiaries of the settlement are represented by an independent indenture trustee and independent counsel?

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IN THE

**Supreme Court of the United States**

OCTOBER TERM, 1982

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No. 82-1985

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In re

W. T. GRANT COMPANY,

*Bankrupt.*

DAVID COSOFF and HELEN FINKELSTEIN,

*Petitioners.*

—against—

CHARLES G. RODMAN, as Trustee of the  
Estate of W. T. GRANT COMPANY, Bankrupt,

*Respondent.*

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ON PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES  
COURT OF APPEALS FOR THE SECOND CIRCUIT

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**BRIEF OF RESPONDENT UNITED STATES TRUST  
COMPANY OF NEW YORK IN OPPOSITION TO  
PETITION FOR A WRIT OF CERTIORARI**

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**CITATIONS TO THE OPINIONS  
OF THE COURTS BELOW**

The United States Court of Appeals for the Second Circuit, 699 F.2d 599 (2d Cir. 1983), (Petitioners' Appendix 3a) rehearing denied March 8, 1983, unanimously affirmed an order of the United States District Court for the Southern District of New

York, 20 B.R. 186 (S.D.N.Y., 1982), (Petitioners' Appendix 34a), which affirmed an order of the United States Bankruptcy Court for the Southern District of New York (Bankr. Ct. S.D.N.Y. 1981), (Respondents' Appendix 1a), which approved a settlement of claims. The Bankruptcy Court order adopted the findings and conclusions from a prior decision which approved an earlier settlement of the same claims. 4 B.R. 53 (Bankr. Ct. S.D.N.Y. 1980) (Respondents' Appendix 5a).

### STATEMENT OF THE CASE

The Petitioners seek a writ of certiorari to the United States Court of Appeals for the Second Circuit ("the Second Circuit") to review a decision and order of the Second Circuit filed January 26, 1983 (the "Decision") and an order which denied a petition for rehearing of the Decision, dated March 8, 1983. The Decision affirmed an order of the United States District Court for the Southern District of New York, dated March 15, 1982 (the "District Court Order"). The District Court Order affirmed an order of the United States Bankruptcy Court for the Southern District of New York, dated June 23, 1981 (the "Bankruptcy Court Order"). The Bankruptcy Court Order authorized and approved an amended offer of settlement by Charles G. Rodman, as trustee (the "Trustee") of the estate of the bankrupt W.T. Grant Company ("Grant"). The amended offer of settlement would resolve the adverse claims of 26 bank claimants of Grant (the "Bank Claimants") and the claims of holders of Grant's 4¾% Convertible Subordinated Debentures due 1996 (the "Debentures") and Grant's 4% Convertible Subordinated Debentures due 1990.

The Bankruptcy Court Order supplemented a prior decision and order, dated February 20, 1980, which is reported at 4 B.R. 53 (Bankr. Ct. S.D.N.Y. 1980) (the "Bankruptcy Court Decision") (Respondent's Appendix 5a). The Bankruptcy Court Decision authorized and approved an offer by the Trustee to settle the claims of the Debentureholders, pursuant to which the Debentureholders would receive a gross payment of 15% of the

principal amount of each Debenture tendered in acceptance of the offer (the "Initial Offer"). Several Debentureholders who objected to the terms of the Initial Offer ("Objectants") took appeals from the Bankruptcy Court Decision to the United States District Court for the Southern District of New York. During the pendency of that appeal, discussions occurred which resulted in a proposed amendment of the Initial Offer (the "Amended Offer"). As a result of the Amended Offer, that appeal was withdrawn by Objectants with prejudice.

The Amended Offer increased the gross amount payable under the Initial Offer to Debentureholders from 15% to 21% of the principal amount of each Debenture tendered in acceptance of the Amended Offer. The gross amount which tendering Debentureholders would receive under the Amended Offer would be reduced by a *pro rata* share of certain fees and expenses; however, the net amount payable to Debentureholders was not to be less than 19% of the principal amount of each Debenture tendered. The Amended Offer specified that no payments could be made to accepting Debentureholders while an appeal or petition for certiorari was pending from an order approving the Amended Offer. The Bankruptcy Court Order approved the Amended Offer relying on the findings in the Bankruptcy Court Decision.

The Bankruptcy Court conducted six days of hearings in connection with the Initial Offer during which five witnesses testified. The transcript of the hearing consisted of 987 pages and 80 exhibits were received in evidence aggregating at least 1,500 additional pages. The participants in those hearings included the Trustee, United States Trust Company of New York ("U.S. Trust"), as Successor Indenture Trustee for the Debentureholders, and the Objectants.

The Amended Offer has been distributed to the Debentureholders. A statement by the Petitioners in opposition to the Amended Offer was distributed to the Debentureholders along with the Amended Offer. As of July 1, 1983, the holders of over \$89 million in principal amount, or over 96% of the principal amount outstanding, of the Debentures, have accepted the Amended Offer by tendering their Debentures.

This case is closely related to the settlement in the case entitled *Weinberger v. Kendrick*, 698 F.2d 61 (2d Cir. 1982), *petition for cert. filed sub nom Lewy v. Weinberger*, 51 U.S.L.W. 3859 (May 17, 1983). *Weinberger* involved claims by various security holders who purchased the Grant securities. The plaintiffs in *Weinberger* alleged that the Bank Claimants had dominated and controlled the Grant management (698 F.2d at 66)—precisely the same allegations which form the basis of the Debentureholders' claims that are resolved by the Amended Offer, on virtually the identical record as in this case and which are the subject of the Decision which Petitioners seek to have this Court review. The Second Circuit affirmed the order approving the *Weinberger* settlement in an extensive decision reviewing the law and the record, found the settlement to be fair, reasonable and adequate, and found neither merit in the same claims on which Petitioners seek to have this Court rule nor factual support in the record to support the claims. 698 F.2d at 75.

This response is submitted by U.S. Trust as successor Indenture Trustee under an indenture dated as of April 15, 1971 between Grant and the Chase Manhattan Bank, N.A., as Indenture Trustee, pursuant to which the Debentures were issued. U.S. Trust, as successor Indenture Trustee, represents the interests of all Debentureholders, and responds to the Petition to protect the interests of the holders of over 96% in principal amount outstanding of the Debentures who have indicated, by tendering their Debentures, their acceptance of the Amended Offer. Petitioners' actions have prevented the accepting Debentureholders from receiving payment for their tendered Debentures because the Trustee is precluded under the Amended Offer from making payment to the Debentureholders while an appeal or a petition for certiorari is pending from the Bankruptcy Court Order. U.S. Trust has participated in these proceedings to represent the interests of the accepting Debentureholders and U.S. Trust urges this Court to deny the petition for a writ of certiorari so that no further prejudice shall be suffered by the overwhelming majority of Debentureholders who have accepted the Amended Offer.

## SUMMARY OF ARGUMENT

The Court should not grant a petition for a writ of certiorari where the petitioner has not demonstrated the existence of any issue which would justify this Court exercising its discretion to issue the writ. Rule 17 of the Rules of the Supreme Court of the United States. The Court should not grant the Petition to review the findings of fact which were affirmed by the District Court and the Court of Appeals.

The Decision approved the settlement of claims in a bankruptcy proceeding. In approving a settlement, a judge must make an informed judgment of the issues. However, a judge approving a settlement is not required to conduct a full-scale trial to evaluate the settlement, but must determine whether the settlement is reasonable. The bankruptcy judge in this case conducted extensive hearings and entered a lengthy opinion in connection with an earlier offer of settlement, which decision was adopted in connection with the Amended Offer. There is no reason for this Court to grant the petition for a writ of certiorari when the Bankruptcy Court properly executed its duties and the District Court and the Court of Appeals found that a proper hearing was held and that the settlement was reasonable. Further, the Court should refrain from granting the Petition and providing a disincentive to the settlement of comparable cases.

There are no findings by any of the lower courts to support the Petitioners' allegations of conflict of interest by the attorneys for the Bankruptcy Trustee. However, regardless of those allegations, the Debentureholders who are the beneficiaries of the settlement were represented by an independent Indenture Trustee and its independent counsel. The Court should not grant the petition on the basis of the alleged conflict of interest where the Debentureholders were independently represented and therefore could not be injured by the alleged conflict.

## ARGUMENT

### *I. Petitioners have failed to show that there are "special and important considerations" for granting the Petition.*

Rule 17 of the Rules of this Court state the standard to be applied on consideration of a petition for a writ of certiorari:

A review on writ of certiorari is not a matter of right, but of judicial discretion, and will be granted only when there are special and important reasons therefor.

The above-quoted sentence is followed by three types of reasons as illustrative of the character of reasons that will be considered.

The petition in this case does not raise any special or important reasons that call for this Court to exercise its discretion to hear his case.

The Decision of the Court of Appeals involved a lengthy and thorough review of issues and affirmed the District Court Order which had affirmed the Bankruptcy Court Order and the extensive Bankruptcy Court Decision. Petitioners seek to raise here a number of factual issues which were resolved against them by the findings of the Bankruptcy Court, and which were affirmed by the District Court and the Court of Appeals. There is no reason for this Court to exercise its discretion to grant a writ of certiorari to review the findings of fact of the lower court. "Granting of the writ would not be warranted merely to review the evidence or the inferences to be drawn from it." *General Talking Pictures Corp. v. Western Electric*, 304 U.S. 175, 178 (1938). This Court has often stated that it will not exercise its discretion to grant certiorari where a case turns on a factual issue decided by the Court of Appeals upon a fair assessment of the record. *Federal Trade Commission v. Standard Oil Co.*, 355 U.S. 396, 398 (1958).

However, the fundamental fact which is ignored or overlooked in the Petition is that the Decision of the Court of Appeals arises in the context of approving a settlement. As set

forth below (Point II) the Court of Appeals and the lower courts applied the correct standard for approving a settlement. The settlement of this case does not provide a proper context for this Court to exercise its discretion to grant the Petition. The Court of Appeals observed at several points in the Decision that the Bankruptcy Court's task, and that of the reviewing courts, was to determine whether the settlement fell below the lowest point in the range of reasonableness. 699 F.2d at 608, 613. *Newman v. Stein* 464 F.2d 689, 693 (2d Cir.) *cert. denied sub nom. Benson v. Newman*, 409 U.S. 1039 (1972).

The Petitioners do not argue that the standard for approving a settlement is different in the Court of Appeals for the Second Circuit than in any other federal court of appeals or state court of last resort. Nor do they argue that the order of the Court of Appeals involves a departure from accepted and usual judicial proceedings. In other words, the Petition fails to raise the kind of issues which this Court has indicated are necessary for this Court to exercise its discretion to review a case on a writ of certiorari.

***II. The Court of Appeals applied the correct standard for reviewing an order approving a settlement of a suit in the Bankruptcy Court.***

The Court of Appeals and the lower courts in their respective decisions correctly emphasized the fact that their task was to consider the approval of a settlement, not to make rulings on the substantive merits of the dispute.

The standards for approval of a settlement such as the one in this case, were set forth by this Court in *Protective Committee for Independent Stockholders of TMT Trailer Ferry, Inc. v. Anderson*, 390 U.S. 414 (1968) ("TMT"). The TMT case stated the standard to be applied by a bankruptcy judge approving a settlement, and requires the judge to make an informed judgment of the issues.

In this case, the Bankruptcy Judge, who had supervised the Grant bankruptcy proceeding since its commencement in October, 1975, conducted six days of hearings, at which five wit-

nesses testified and 80 exhibits were received in evidence. The Bankruptcy Trustee, the Bank Claimants, the Indenture Trustee and the Objectants all appeared and were heard at those hearings. After the close of the hearings the Bankruptcy Judge, in a "careful and well-reasoned" decision considered each of the elements in the *TMT* standard, reviewed the extensive record and the law applicable to the facts. *Weinberger v. Kendrick*, 698 F.2d at 74.

The *TMT* standards do not require the bankruptcy judge to conduct a full-scale trial in connection with a settlement. *City of Detroit v. Grinnell Corp.* 495 F.2d 448, 462 (2d Cir. 1974) ("The Court must eschew any rubber stamp approval in favor of an independent evaluation, yet at the same time stop short of the detailed and thorough investigation that it would undertake if it were actually trying the case." 495 F.2d at 462), *Weinberger v. Kendrick*, *supra*, ("The Supreme Court could not have intended that, in order to avoid a trial, the judge must in effect conduct one." 698 F.2d at 74). See also, *Newman v. Stein*, 464 F.2d 689 (2d Cir.) *cert. denied sub. nom. Benson v. Newman*, 409 U.S. 1039 (1972).

As noted by the Court of Appeals, the issue in reviewing the Bankruptcy Court Order is not whether the settlement was the best that could have been obtained, but whether it "fall[s] below the lowest point in the range of reasonableness" *Newman v. Stein*, *supra* 464 F.2d at 693. As viewed by the Court of Appeals, this settlement "can hardly be regarded as below the lowest point in the range of reasonableness." 699 F.2d at 614.

The Petitioners do not contest that the above described standards are the proper ones, or that some other federal court of appeals would apply the standards differently. Therefore, there is no basis for this Court to exercise its discretion to grant a writ of certiorari and hear this case. See Point I, *supra*.

There is a valid policy reason to deny the Petition. The parties resolved to settle this suit to avoid the time, expense and uncertainty of litigation. The decision approving the initial settlement was entered February 20, 1980 and has since been the subject of lengthy appeals which have brought the case to its present

posture. The holders of over 96% in principal amount of Debentures have accepted the settlement by tendering their Debentures. Those who have accepted the offer have not collected one cent of the settlement fund to which they are entitled because of the appeals by the Petitioners. The benefits of a settlement are lost, and a major inducement to settle is removed, if settlements can be delayed indefinitely by appeals. If this Court were to grant the Petition, it would not only further delay the settlement in this case, but would deter parties in other litigations from settling where receipt of the settlement proceeds could be indefinitely delayed by extended appeals. Because there is no clear and compelling reason to issue a writ of certiorari in this case, this Court should deny the Petition.

***III. The Court should not grant certiorari on the basis of the allegations of conflict of interest of the Trustee's counsel.***

The Petition asserts that the Court should grant the petition for a writ of certiorari and reverse the decision of the Court of Appeals on the grounds that the counsel to the Trustee has an alleged conflict of interest. These allegations were considered by the lower courts and the Court of Appeals and found neither to be supported by the evidence nor the basis for disqualification. Specifically, the Court of Appeals held that representation of creditors or a creditors' committee does not disqualify a lawyer from representing a bankruptcy trustee. (699 F.2d at 613) The Bankruptcy Judge who observed the actions of the Trustee's counsel concluded that they "have served him and the creditors of the bankrupt estate with vigor, objectivity and independence." (699 F.2d at 613).

Furthermore, the Debentureholders who are the beneficiaries of the settlement in this case were represented by an independent Indenture Trustee and independent counsel. U.S. Trust and its counsel participated actively in all aspects of the Grant proceeding. U.S. Trust on behalf of the Debentureholders initiated many of the allegations against the Bank Claimants which are the subject of the settled controversy and U.S. Trust represented the Debentureholders in the negotiations which

resulted in both the Initial Offer and the Amended Offer. Therefore, regardless of the accusations against the Trustee's counsel, the interests of the Debentureholders have been independently represented at all times by the Indenture Trustee and its counsel. The Court should not exercise its discretion and grant the Petition where unsupported allegations are being used to suggest an issue which is lacking in substance, and particularly where the Debentureholders were represented by an independent Indenture Trustee and independent counsel.

### CONCLUSION

For the foregoing reasons, the Court should deny the Petition for a writ of certiorari in this case and award U.S. Trust double costs pursuant to 28 U.S. Code 1912 and Rule 50.7 of the Rules of this Court.

Respectfully submitted,

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